

FINANCIAL SECTION



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Independent Auditor's Report

The Honorable James B. Hunt, Jr., Governor
The General Assembly of North Carolina
The Citizens of North Carolina

We have audited the accompanying general purpose financial statements of the State of North Carolina as of and for the year ended June 30, 1998. These general purpose financial statements are the responsibility of the State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the 401-K Supplemental Retirement Income Plan, which represent 36 percent and 39 percent, respectively, of the assets and revenues of the expendable trust funds; the financial statements of the North Carolina Housing Finance Agency, which represent 45 percent and 34 percent, respectively, of the assets and revenues of the proprietary component units; nor the financial statements of the State Education Assistance Authority, which represent 36 percent and 26 percent, respectively, of the assets and revenues of the proprietary component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the 401-K Supplemental Retirement Income Plan were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the State of North Carolina as of June 30, 1998, and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds for the year then ended in conformity with generally accepted accounting principles.



As discussed in Note 1W to the financial statements, the State of North Carolina implemented Governmental Accounting Standards Board Statement 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*; and Statement 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans* during the year ended June 30, 1998. As discussed in Note 1F to the financial statements, the State of North Carolina changed its method of accounting for securities lending transactions during the year ended June 30, 1998.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 4, 1998, except for the first paragraph, as to which the date is April 20, 1999, on our consideration of the State of North Carolina's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. This report will be published at a later date in the State of North Carolina's *Single Audit Report*.

The required supplementary information on year 2000 issues listed in the table of contents is not a required part of the general purpose financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because we could not evaluate the information using the criteria in Governmental Accounting Standards Board Technical Bulletin 98-1, *Disclosures About Year 2000 Issues*, as amended. In addition, we do not provide assurance that the State is or will become year 2000 compliant, that the State's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the State does business are or will become year 2000 compliant.

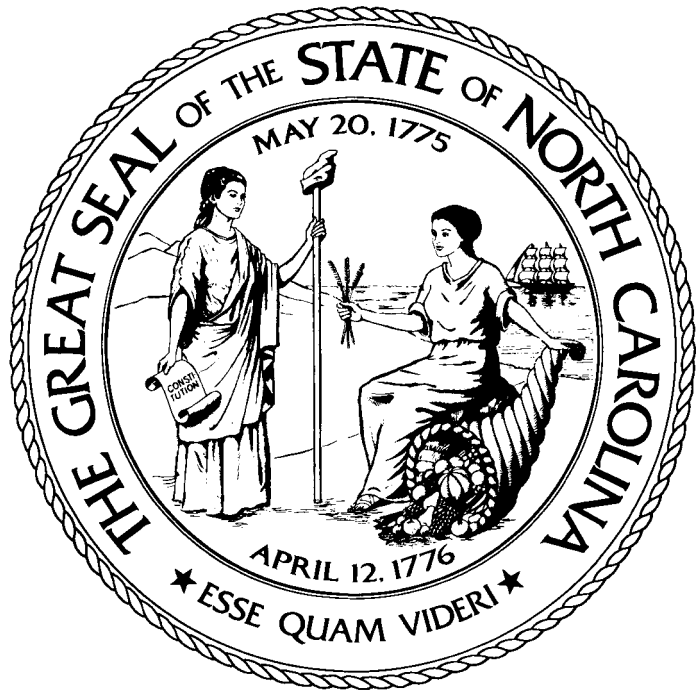
The combining and individual fund and account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based on our audit and the reports of other auditors, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.



Ralph Campbell, Jr.
State Auditor

December 4, 1998, except for Note 20,
as to which the date is April 20, 1999

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*GENERAL
PURPOSE
FINANCIAL
STATEMENTS*

ALL FUND TYPES, ACCOUNT GROUPS, AND DISCRETELY PRESENTED COMPONENT UNITS COMBINED BALANCE SHEET

June 30, 1998

(Dollars in Thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
ASSETS AND OTHER DEBITS					
Cash and cash equivalents (Note 4).....	\$ 2,504,859	\$ 2,409,353	\$ 282,895	\$ 29,123	\$ 420,441
Investments (Note 4).....	3,019,561	1,044,896	—	41,632	671,024
Deposit with Federal government (Note 4).....	—	—	—	—	—
Receivables, net:					
Taxes receivable.....	675,428	103,133	—	—	—
Accounts receivable.....	101,960	11,385	203	1,622	19,551
Intergovernmental receivables.....	440,646	92,766	176	—	547
Interest receivable.....	21,657	8,800	—	116	1,942
Premiums receivable.....	—	—	—	812	497
Contributions receivable.....	14,519	—	—	—	5,044
Other receivables.....	—	6,962	—	—	—
Due from other funds (Note 8).....	12,045	35,865	3,250	—	23,556
Due from component units (Note 8).....	20,179	—	—	—	1,266
Due from primary government (Note 8).....	—	—	—	—	—
Advances to component units (Note 8).....	94,054	—	—	—	—
Notes receivable.....	497	112,371	—	—	—
Inventories.....	48,997	81,887	—	386	13,784
Food stamps.....	93,695	—	—	—	—
Prepaid items.....	67	1,290	—	1,287	482
Fixed assets (Note 5).....	—	—	—	23,225	165,678
Sureties.....	—	32,802	—	—	—
Amount available in other funds.....	—	—	—	—	—
Amount to be provided for retirement of general long-term obligations.....	—	—	—	—	—
Total Assets and Other Debits.....	<u>\$ 7,048,164</u>	<u>\$ 3,941,510</u>	<u>\$ 286,524</u>	<u>\$ 98,203</u>	<u>\$1,323,812</u>
LIABILITIES, FUND EQUITY AND OTHER CREDITS					
Liabilities:					
Accounts payable and accrued liabilities.....	\$ 433,120	\$ 233,036	\$ 19,949	\$ 267	\$ 13,603
Tax refunds payable.....	708,708	—	—	—	—
Obligations under securities lending.....	2,958,149	1,022,734	—	17,443	299,771
Retiree tax judgements payable (Note 7).....	400,000	—	—	—	—
Intangibles tax judgements payable (Note 7).....	—	—	—	—	—
Due to other funds (Note 8).....	23,939	41,758	70	9	2,900
Due to component units (Note 8).....	4,278	46,984	221	—	—
Due to primary government (Note 8).....	—	—	—	—	—
Advance from primary government (Note 8).....	—	—	—	—	—
Obligations under reverse repurchase agreements.....	—	—	—	—	—
Contracts payable.....	—	—	—	—	—
Notes payable (Note 7).....	—	—	—	130	—
Claims and benefits payable.....	444,171	55	—	9,024	346,622
Capital leases payable (Note 6).....	—	—	—	—	—
Bonds payable (Note 7).....	—	—	—	—	—
Interest payable.....	—	—	—	—	—
Deposits payable.....	—	93,837	7,700	—	63
Distributions payable.....	—	—	—	—	—
Accrued vacation leave.....	—	—	—	300	2,876
Deferred revenue.....	411,149	18,533	—	2,318	3,544
Total Liabilities.....	<u>5,383,514</u>	<u>1,456,937</u>	<u>27,940</u>	<u>29,491</u>	<u>669,379</u>
Fund Equity and Other Credits:					
Contributed capital.....	—	—	—	36,365	58,850
Retained earnings.....	—	—	—	32,347	595,583
Investment in fixed assets.....	—	—	—	—	—
Fund balances:					
Reserved/restricted (Note 15).....	1,219,621	940,304	88,871	—	—
Unreserved/unrestricted.....	445,029	1,544,269	169,713	—	—
Total Fund Equity and Other Credits.....	<u>1,664,650</u>	<u>2,484,573</u>	<u>258,584</u>	<u>68,712</u>	<u>654,433</u>
Total Liabilities, Fund Equity and Other Credits.....	<u>\$ 7,048,164</u>	<u>\$ 3,941,510</u>	<u>\$ 286,524</u>	<u>\$ 98,203</u>	<u>\$1,323,812</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-1

<i>Fiduciary Fund Types</i>	<i>Account Groups</i>		<i>TOTAL PRIMARY GOVERNMENT (Memorandum only)</i>	<i>Component Units</i>		<i>TOTAL REPORTING ENTITY (Memorandum only)</i>
<i>Trust and Agency</i>	<i>General Fixed Assets</i>	<i>General Long-Term Obligations</i>		<i>Proprietary</i>	<i>College and University</i>	
\$ 1,224,695	\$ —	\$ —	\$ 6,871,366	\$ 205,518	\$ 1,551,580	\$ 8,628,464
55,687,867	—	—	60,464,980	762,590	2,561,331	63,788,901
1,285,741	—	—	1,285,741	—	—	1,285,741
203,260	—	—	981,821	—	—	981,821
15,155	—	—	149,876	17,979	204,093	371,948
7,792	—	—	541,927	8,135	118,841	668,903
8,147	—	—	40,662	20,946	11,547	73,155
—	—	—	1,309	—	—	1,309
127,847	—	—	147,410	—	—	147,410
—	—	—	6,962	—	—	6,962
5,349	—	—	80,065	—	66,637	146,702
—	—	—	21,445	—	1,753	23,198
—	—	—	—	13,494	51,288	64,782
25,000	—	—	119,054	—	—	119,054
337,296	—	—	450,164	1,300,877	84,127	1,835,168
1,433	—	—	146,487	802	52,500	199,789
—	—	—	93,695	—	—	93,695
—	—	—	3,126	5,552	7,744	16,422
—	3,178,549	—	3,367,452	188,374	5,772,790	9,328,616
508,872	—	—	541,674	—	—	541,674
—	—	103	103	—	—	103
—	—	3,058,990	3,058,990	—	—	3,058,990
<u>\$ 59,438,454</u>	<u>\$ 3,178,549</u>	<u>\$ 3,059,093</u>	<u>\$ 78,374,309</u>	<u>\$ 2,524,267</u>	<u>\$ 10,484,231</u>	<u>\$ 91,382,807</u>
\$ 538,041	\$ —	\$ —	\$ 1,238,016	\$ 28,037	\$ 188,667	\$ 1,454,720
—	—	—	708,708	—	—	708,708
4,104,051	—	—	8,402,148	170,406	726,748	9,299,302
—	—	399,000	799,000	—	—	799,000
—	—	333,000	333,000	—	—	333,000
11,389	—	—	80,065	—	66,637	146,702
13,299	—	—	64,782	113	1,640	66,535
—	—	—	—	16,843	3,686	20,529
—	—	—	—	58,054	—	58,054
—	—	—	—	—	161,152	161,152
—	—	—	—	7,395	—	7,395
—	—	4,166	4,296	92,022	43,520	139,838
163,592	—	7,401	970,865	16	39,014	1,009,895
—	—	190	190	3,277	496	3,963
—	—	2,123,944	2,123,944	1,328,636	838,993	4,291,573
—	—	—	—	19,938	12,409	32,347
733,473	—	—	835,073	62	396,447	1,231,582
1,454	—	—	1,454	—	—	1,454
—	—	191,392	194,568	1,500	129,422	325,490
66,865	—	—	502,409	7,903	25,962	536,274
<u>5,632,164</u>	<u>—</u>	<u>3,059,093</u>	<u>16,258,518</u>	<u>1,734,202</u>	<u>2,634,793</u>	<u>20,627,513</u>
—	—	—	95,215	203,496	—	298,711
—	—	—	627,930	586,569	—	1,214,499
—	3,178,549	—	3,178,549	—	4,977,606	8,156,155
52,164,871	—	—	54,413,667	—	1,560,829	55,974,496
1,641,419	—	—	3,800,430	—	1,311,003	5,111,433
<u>53,806,290</u>	<u>3,178,549</u>	<u>—</u>	<u>62,115,791</u>	<u>790,065</u>	<u>7,849,438</u>	<u>70,755,294</u>
<u>\$ 59,438,454</u>	<u>\$ 3,178,549</u>	<u>\$ 3,059,093</u>	<u>\$ 78,374,309</u>	<u>\$ 2,524,267</u>	<u>\$ 10,484,231</u>	<u>\$ 91,382,807</u>

ALL GOVERNMENTAL FUND TYPES AND EXPENDABLE TRUST FUNDS COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 1998

Exhibit A-2

(Dollars in Thousands)

	Governmental Fund Types			Fiduciary Fund Type	TOTALS
	General	Special Revenue	Capital Projects	Expendable Trust	(Memorandum only)
Revenues:					
Taxes.....	\$ 11,679,679	\$ 1,607,930	\$ —	\$ 285,772	\$ 13,573,381
Federal funds.....	5,174,406	801,975	6,622	9,342	5,992,345
Local funds.....	436,347	26,515	17	273	463,152
Investment earnings.....	447,669	128,232	—	409,444	985,345
Interest earnings on loans.....	—	5,676	—	6,640	12,316
Sales and services.....	67,533	16,037	517	29,199	113,286
Sale, rental, and lease of property.....	6,066	20,015	240	502	26,823
Fees, licenses, and fines.....	244,674	581,817	—	8,871	835,362
Contributions, gifts, and grants.....	13,206	29,194	18,789	193,520	254,709
Funds escheated.....	—	—	—	18,866	18,866
Miscellaneous.....	137,269	11,426	99	413	149,207
Total revenues.....	<u>18,206,849</u>	<u>3,228,817</u>	<u>26,284</u>	<u>962,842</u>	<u>22,424,792</u>
Expenditures:					
Current:					
General government.....	1,079,048	36,715	—	12,686	1,128,449
Education.....	5,017,690	398,796	—	19,287	5,435,773
Health and human services.....	7,255,348	44,914	—	1,923	7,302,185
Economic development.....	122,032	199,581	—	—	321,613
Environment and natural resources.....	206,945	125,858	—	8,986	341,789
Public safety, corrections, and regulation..	1,403,276	175,709	—	29,451	1,608,436
Transportation.....	—	2,384,455	—	—	2,384,455
Agriculture.....	68,289	284	—	4,901	73,474
Claims and benefits.....	—	—	—	473,353	473,353
Retiree tax judgements.....	400,000	—	—	—	400,000
Capital outlay.....	—	—	203,605	—	203,605
Debt service:					
Bond principal retirement.....	91,585	—	—	—	91,585
Bond interest.....	73,229	5,225	—	—	78,454
Total expenditures.....	<u>15,717,442</u>	<u>3,371,537</u>	<u>203,605</u>	<u>550,587</u>	<u>19,843,171</u>
Excess revenues over (under) expenditures.....	<u>2,489,407</u>	<u>(142,720)</u>	<u>(177,321)</u>	<u>412,255</u>	<u>2,581,621</u>
Other Financing Sources (Uses):					
Operating transfers in.....	291,221	756,309	168,019	20,581	1,236,130
Operating transfers from component units.....	14,692	724	1,207	—	16,623
Operating transfers out.....	(470,456)	(745,267)	(2,030)	(15,739)	(1,233,492)
Operating transfers to component units.....	(2,358,657)	(15,190)	(350)	(13,299)	(2,387,496)
Proceeds from bond sale.....	—	700,000	—	—	700,000
Total other financing sources (uses).....	<u>(2,523,200)</u>	<u>696,576</u>	<u>166,846</u>	<u>(8,457)</u>	<u>(1,668,235)</u>
Excess revenues and other sources over (under) expenditures and other uses.....	<u>(33,793)</u>	<u>553,856</u>	<u>(10,475)</u>	<u>403,798</u>	<u>913,386</u>
Fund balances — July 1 (Note 16).....	1,707,418	1,936,458	280,444	3,349,203	7,273,523
Restatements (Note 16).....	384	(210)	—	(1)	173
Residual equity transfers in (Note 17).....	55	37	—	—	92
Residual equity transfers out (Note 17).....	(9,769)	(9,943)	(11,385)	(151)	(31,248)
Increase (decrease) in reserve for related assets.....	<u>355</u>	<u>4,375</u>	<u>—</u>	<u>100</u>	<u>4,830</u>
Fund balances — June 30.....	<u>\$ 1,664,650</u>	<u>\$ 2,484,573</u>	<u>\$ 258,584</u>	<u>\$ 3,752,949</u>	<u>\$ 8,160,756</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

GENERAL FUND AND SPECIAL REVENUE FUNDS
COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
UNRESERVED FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)

For the Fiscal Year Ended June 30, 1998

Exhibit A-3

(Dollars in Thousands)

	General Fund			Special Revenue Funds		
	<u>Final Budget</u>	<u>Actual</u>	<u>Variance- Favorable (Unfavorable)</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance- Favorable (Unfavorable)</u>
Revenues:						
Taxes:						
Individual income.....	\$ 5,546,500	\$ 6,028,870	\$ 482,370	\$ —	\$ —	\$ —
Corporate income.....	679,600	696,339	16,739	—	—	—
Sales and use.....	3,249,100	3,255,372	6,272	—	—	—
Franchise.....	409,900	407,257	(2,643)	—	—	—
Insurance.....	269,700	283,763	14,063	—	—	—
Beverage.....	152,700	153,724	1,024	—	—	—
Intangibles.....	—	320	320	—	—	—
Other.....	253,800	266,802	13,002	—	—	—
Non-Tax:						
Fees, licenses and fines.....	116,800	112,790	(4,010)	—	—	—
Investment income.....	237,400	248,131	10,731	—	—	—
Other.....	95,500	91,161	(4,339)	—	—	—
Transfers in.....	182,600	182,600	—	—	—	—
Departmental:						
Federal funds.....	5,301,525	4,817,261	(484,264)	293,907	227,940	(65,967)
Local funds.....	710,088	592,637	(117,451)	13,210	11,919	(1,291)
Inter-agency grants and allocations.....	34,354	4,516	(29,838)	23,782	17,669	(6,113)
Intra-governmental transactions.....	1,906,252	1,739,009	(167,243)	425,365	406,873	(18,492)
Sales and services.....	64,421	66,499	2,078	11,786	12,785	999
Sale, rental and lease of property.....	4,425	4,321	(104)	2,161	3,659	1,498
Fees, licenses and fines.....	101,748	102,310	562	89,919	97,187	7,268
Contributions, gifts and grants.....	42,357	32,423	(9,934)	1,527	1,469	(58)
Miscellaneous.....	73,517	52,972	(20,545)	14,924	10,883	(4,041)
Universities.....	472,182	457,332	(14,850)	87,449	87,801	352
Total Revenues.....	<u>19,904,469</u>	<u>19,596,409</u>	<u>(308,060)</u>	<u>964,030</u>	<u>878,185</u>	<u>(85,845)</u>
Expenditures:						
Current:						
General government.....	552,558	534,563	17,995	154,603	77,972	76,631
Education.....	6,341,188	6,208,442	132,746	—	—	—
Health and human services.....	8,631,327	8,158,386	472,941	74,134	63,530	10,604
Environment and natural resources.....	281,513	252,300	29,213	157,645	133,396	24,249
Economic development.....	197,850	164,695	33,155	280,942	215,246	65,696
Public safety, corrections, and regulation...	1,760,590	1,490,821	269,769	260,153	233,123	27,030
Transportation.....	10,610	10,610	—	—	—	—
Agriculture.....	75,791	70,706	5,085	—	—	—
Capital outlay.....	327,252	327,252	—	—	—	—
Debt service.....	166,035	164,814	1,221	—	—	—
Universities.....	1,951,989	1,922,830	29,159	124,492	88,975	35,517
Total Expenditures.....	<u>20,296,703</u>	<u>19,305,419</u>	<u>991,284</u>	<u>1,051,969</u>	<u>812,242</u>	<u>239,727</u>
Excess revenues over (under) expenditures.....	(392,234)	290,990	683,224	(87,939)	65,943	153,882
Transfers from reserves (Note 2C).....	174,545	174,545	—	—	—	—
Transfers to reserves (Note 2C).....	—	(268,995)	(268,995)	—	—	—
Unreserved fund balances (budgetary basis) at July 1, 1997.....	<u>318,690</u>	<u>318,690</u>	<u>—</u>	<u>192,498</u>	<u>192,498</u>	<u>—</u>
Unreserved fund balances (budgetary basis) at June 30, 1998 (Note 2B).....	<u>\$ 101,001</u>	<u>\$ 515,230</u>	<u>\$ 414,229</u>	<u>\$ 104,559</u>	<u>\$ 258,441</u>	<u>\$ 153,882</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

**ALL PROPRIETARY FUND TYPES, SIMILAR TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY**

For the Fiscal Year Ended June 30, 1998

(Dollars in Thousands)

	Proprietary Fund Types		Fiduciary Fund Types	TOTAL PRIMARY GOVERNMENT
	Enterprise	Internal Service	Nonexpendable Trust	(Memorandum only)
Operating Revenues:				
Sales and services.....	\$ 1,256	\$ 268,310	\$ 423	\$ 269,989
Federal funds.....	—	—	25,273	25,273
Investment earnings.....	5,687	85,328	13,661	104,676
Interest earnings on loans.....	—	—	7,271	7,271
Rental and lease earnings.....	3,566	11	—	3,577
Fees, licenses and fines.....	6,474	1,043	1,314	8,831
Contributions.....	—	65,459	4	65,463
Insurance premiums.....	6,713	581,613	—	588,326
Miscellaneous.....	22	2,505	219	2,746
Total operating revenues.....	<u>23,718</u>	<u>1,004,269</u>	<u>48,165</u>	<u>1,076,152</u>
Operating Expenses:				
Personal services.....	5,547	50,622	14	56,183
Supplies and materials.....	534	13,548	5	14,087
Services.....	4,175	81,337	9	85,521
Interest.....	847	15,693	2,887	19,427
Cost of goods sold.....	465	38,983	—	39,448
Depreciation/amortization.....	1,458	29,131	—	30,589
Grants to local governments.....	—	—	2,788	2,788
Claims and benefits.....	10,152	731,608	—	741,760
Insurance and bonding.....	2,579	10,916	—	13,495
Other.....	1,063	26,024	445	27,532
Total operating expenses.....	<u>26,820</u>	<u>997,862</u>	<u>6,148</u>	<u>1,030,830</u>
Operating income (loss).....	(3,102)	6,407	42,017	45,322
Net Nonoperating Revenues (Expenses).....	<u>334</u>	<u>106</u>	<u>—</u>	<u>440</u>
Income (loss) before operating transfers.....	<u>(2,768)</u>	<u>6,513</u>	<u>42,017</u>	<u>45,762</u>
Operating Transfers:				
Transfers in.....	290	2,822	14,499	17,611
Transfers from component units.....	—	—	—	—
Transfers from primary government.....	—	—	—	—
Transfers out.....	(127)	(16,941)	(3,181)	(20,249)
Transfers to primary government.....	—	—	—	—
Total operating transfers in (out).....	<u>163</u>	<u>(14,119)</u>	<u>11,318</u>	<u>(2,638)</u>
Net income (loss).....	(2,605)	(7,606)	53,335	43,124
Excess of revenues over (under) expenditures from governmental operations.....	—	—	—	—
Fund equity — July 1 (Note 16).....	64,968	661,422	358,737	1,085,127
Restatements (Note 16).....	—	573	(20)	553
Increase (decrease) in contributed capital.....	6,349	44	—	6,393
Fund equity — June 30.....	<u>\$ 68,712</u>	<u>\$ 654,433</u>	<u>\$ 412,052</u>	<u>\$ 1,135,197</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-4

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
\$ 57,416	\$ 327,405
—	25,273
44,943	149,619
98,293	105,564
5,556	9,133
183	9,014
—	65,463
—	588,326
6,245	8,991
<u>212,636</u>	<u>1,288,788</u>
40,083	96,266
11,688	25,775
30,273	115,794
85,164	104,591
—	39,448
18,170	48,759
—	2,788
631	742,391
1,529	15,024
13,171	40,703
<u>200,709</u>	<u>1,231,539</u>
11,927	57,249
<u>(66,270)</u>	<u>(65,830)</u>
<u>(54,343)</u>	<u>(8,581)</u>
—	17,611
9,531	9,531
113,621	113,621
—	(20,249)
(51)	(51)
<u>123,101</u>	<u>120,463</u>
68,758	111,882
(1,086)	(1,086)
707,920	1,793,047
(7,452)	(6,899)
21,925	28,318
<u>\$ 790,065</u>	<u>\$ 1,925,262</u>

**ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS
COMBINED STATEMENT OF CASH FLOWS**

For the Fiscal Year Ended June 30, 1998

(Dollars in Thousands)

	Proprietary Fund Types		Fiduciary Fund Types	TOTAL PRIMARY GOVERNMENT
	Enterprise	Internal Service	Nonexpendable Trust Funds	(Memorandum only)
Cash Provided From (Used For)				
Operations:				
Operating income (loss).....	\$ (3,102)	\$ 6,407	\$ 42,017	\$ 45,322
Adjustments to reconcile operating income to net cash flows from operating activities:				
Depreciation/amortization.....	1,458	29,131	—	30,589
Investment earnings.....	(5,687)	(85,328)	(13,661)	(104,676)
Securities lending fees.....	847	15,692	2,887	19,426
Construction projects expensed.....	—	—	—	—
Mortgage/loan/note principal repayments.....	—	—	15,421	15,421
Loan sales.....	—	—	—	—
Mortgages/loans/notes issued.....	—	—	(39,064)	(39,064)
Mortgage/loan/note cancellation and writeoffs.....	—	—	—	—
Allowances and uncollectible accounts.....	—	—	—	—
Restatements and adjustments to cash.....	35	609	67	711
Development stage expense.....	—	—	—	—
Nonoperating miscellaneous income/expense.....	(62)	167	—	105
Interest expense.....	—	—	—	—
(Increases) decreases in assets:				
Receivables.....	5,468	(4,028)	(34)	1,406
Due from other funds.....	—	(4,454)	—	(4,454)
Due from component units.....	—	(32)	—	(32)
Due from primary government.....	—	—	—	—
Inventories.....	15	(1,747)	—	(1,732)
Prepaid items.....	353	(279)	—	74
Increases (decreases) in liabilities:				
Accounts payable and accrued liabilities.....	48	2,838	(262)	2,624
Due to other funds.....	(1)	152	—	151
Due to component units.....	—	(2,197)	—	(2,197)
Due to primary government.....	—	—	—	—
Claims and benefits payable.....	1,158	21,017	—	22,175
Contracts payable.....	—	—	—	—
Deposits payable.....	—	2	—	2
Accrued vacation leave.....	35	197	—	232
Deferred revenue.....	274	482	—	756
Total cash provided from (used for) operations.....	839	(21,371)	7,371	(13,161)
Cash Provided From (Used For)				
Noncapital Financing Activities:				
Proceeds from sale of bonds/notes.....	—	—	—	—
Repayment of bond/note principal.....	—	—	—	—
Interest payments on bonds and notes.....	—	—	—	—
Bond issuance cost.....	—	—	—	—
Grants.....	—	—	—	—
Grants, aid and subsidies.....	—	—	—	—
Operating transfers in.....	290	2,822	14,499	17,611
Operating transfers from component units.....	—	—	—	—
Operating transfers from primary government.....	—	—	—	—
Operating transfers out.....	(12)	(16,940)	(3,181)	(20,133)
Operating transfers to primary government.....	—	—	—	—
Advance from primary government.....	—	—	—	—
Nonoperating cash donations.....	172	—	—	172
Increase in contributed capital.....	4,614	—	—	4,614
Decrease in contributed capital.....	—	—	—	—
Long term contract payments.....	—	—	—	—
Total cash provided from (used for) noncapital financing activities.....	5,064	(14,118)	11,318	2,264

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-5

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
\$ 11,927	\$ 57,249
18,170	48,759
(44,943)	(149,619)
5,657	25,083
5	5
111,852	127,273
1,140	1,140
(308,890)	(347,954)
6,984	6,984
1,944	1,944
(5,873)	(5,162)
(2,969)	(2,969)
1,105	1,210
55,835	55,835
(8,732)	(7,326)
—	(4,454)
—	(32)
108	108
(48)	(1,780)
(323)	(249)
2,010	4,634
—	151
(58)	(2,255)
(10)	(10)
—	22,175
4,652	4,652
(259)	(257)
166	398
(360)	396
<u>(150,910)</u>	<u>(164,071)</u>
327,400	327,400
(103,040)	(103,040)
(61,159)	(61,159)
(2,787)	(2,787)
3,398	3,398
(70,114)	(70,114)
—	17,611
9,531	9,531
113,621	113,621
—	(20,133)
(51)	(51)
2,427	2,427
3,699	3,871
500	5,114
(3,898)	(3,898)
(4,115)	(4,115)
<u>215,412</u>	<u>217,676</u>

Continued

**ALL PROPRIETARY FUND TYPES, NONEXPENDABLE TRUST FUNDS, AND
DISCRETELY PRESENTED COMPONENT UNITS**
COMBINED STATEMENT OF CASH FLOWS (continued)

For the Fiscal Year Ended June 30, 1998

(Dollars in Thousands)

	Proprietary Fund Types		Fiduciary Fund Types	TOTAL PRIMARY GOVERNMENT
	Enterprise	Internal Service	Nonexpendable Trust Funds	(Memorandum only)
Cash Provided From (Used For)				
Capital Financing Activities:				
Acquisition of fixed assets.....	(91)	(38,748)	—	(38,839)
Proceeds from the sale of fixed assets.....	19	2,817	—	2,836
Proceeds from sale of bonds/notes.....	—	—	—	—
Repayment of bond/note principal.....	(40)	—	—	(40)
Interest payments on bonds, notes and capital leases.....	(11)	—	—	(11)
Bond issuance cost.....	—	—	—	—
Operating transfers out.....	(115)	—	—	(115)
Capital grants.....	—	—	—	—
Principal payment on capital leases.....	—	—	—	—
Dredging costs.....	—	—	—	—
Total cash provided from (used for).....				
capital financing activities.....	(238)	(35,931)	—	(36,169)
Cash Provided From (Used For)				
Investment Activities:				
Proceeds from the sale/maturities of non-State				
Treasurer investments.....	542	—	137	679
Redemptions from the State Treasurer				
Long-Term Investment Pool.....	—	2,000	3,251	5,251
Purchase of non-State Treasurer investments.....	(811)	—	(126)	(937)
Purchase into State Treasurer				
Long-Term Investment Pool.....	(7,500)	(8,600)	(1,470)	(17,570)
Investment earnings.....	1,447	25,229	4,744	31,420
Total cash provided from (used for)				
investment activities.....	(6,322)	18,629	6,536	18,843
Net increase (decrease) in cash				
and cash equivalents.....	(657)	(52,791)	25,225	(28,223)
Deficit from governmental operations.....	—	—	—	—
Cash and cash equivalents at July 1.....	29,780	473,232	82,508	585,520
Cash and cash equivalents at June 30.....	<u>\$ 29,123</u>	<u>\$ 420,441</u>	<u>\$ 107,733</u>	<u>\$ 557,297</u>
Noncash Investing, Capital, and Financing Activities:				
Noncash distributions from the State Treasurer				
Long-Term Investment Pool.....	\$ 3,401	\$ 44,636	\$ 5,869	\$ 53,906
Increase in contributed capital.....	1,826	52	—	1,878
Decrease in contributed capital.....	(91)	(8)	—	(99)
Assets acquired through the assumption of a				
liability.....	17,443	299,771	74,069	391,283
Interest expense on advance from primary				
government.....	—	—	—	—
Cash and cash equivalents in the Fiduciary Fund Types on the Combined Balance Sheet include:				
Expendable Trust Funds.....	\$ 409,311			
Nonexpendable Trust Funds.....	107,733			
Pension Trust Funds.....	99,517			
Investment Trust Fund.....	3,959			
Agency Funds.....	604,175			
Total.....	<u>\$ 1,224,695</u>			

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit A-5

Component Units	TOTAL REPORTING ENTITY
Proprietary Fund Types	(Memorandum only)
(45,206)	(84,045)
4,220	7,056
63,360	63,360
(4,483)	(4,523)
(3,483)	(3,494)
(1,898)	(1,898)
—	(115)
21,872	21,872
(3,730)	(3,730)
(337)	(337)
<u>30,315</u>	<u>(5,854)</u>

507,616	508,295
—	5,251
(621,622)	(622,559)
(442)	(18,012)
<u>34,239</u>	<u>65,659</u>
<u>(80,209)</u>	<u>(61,366)</u>
14,608	(13,615)
1,086	1,086
189,824	775,344
<u>\$ 205,518</u>	<u>\$ 762,815</u>

\$ 7,181	\$ 61,087
—	1,878
—	(99)
61,210	452,493
4,966	4,966

PENSION TRUST FUNDS
COMBINING STATEMENT OF PLAN NET ASSETS
DEFINED BENEFIT PENSION PLANS

June 30, 1998

Exhibit A-6

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	Totals
ASSETS							
Cash and cash equivalents.....	\$ 87,891	\$ 561	\$ 190	\$ 268	\$ 198	\$ 10,409	\$ 99,517
Receivables:							
Accounts receivable.....	212	—	—	—	—	202	414
Interest receivable.....	470	3	1	3	1	303	781
Contributions receivable.....	92,389	916	87	—	—	24,573	117,965
Investments, at fair value:							
State Treasurer investment pool...	41,849,894	310,446	24,034	229,701	42,103	10,389,827	52,846,005
Total Assets.....	<u>42,030,856</u>	<u>311,926</u>	<u>24,312</u>	<u>229,972</u>	<u>42,302</u>	<u>10,425,314</u>	<u>53,064,682</u>
LIABILITIES							
Obligations under							
securities lending.....	2,850,420	21,233	1,799	15,704	3,073	711,399	3,603,628
Due to other funds.....	—	—	—	1	—	—	1
Benefits payable.....	126,275	—	—	—	1	98	126,374
Total Liabilities.....	<u>2,976,695</u>	<u>21,233</u>	<u>1,799</u>	<u>15,705</u>	<u>3,074</u>	<u>711,497</u>	<u>3,730,003</u>
Fund Balance							
Reserved for employees'							
pension benefits (Note 15).....	<u>\$ 39,054,161</u>	<u>\$ 290,693</u>	<u>\$ 22,513</u>	<u>\$ 214,267</u>	<u>\$ 39,228</u>	<u>\$ 9,713,817</u>	<u>\$ 49,334,679</u>

A schedule of funding progress for each plan is presented on page 110 .

The accompanying Notes to the Financial Statements are an integral part of this statement.

PENSION TRUST FUNDS
COMBINING STATEMENT OF CHANGES IN PLAN NET ASSETS
DEFINED BENEFIT PENSION PLANS

For the Fiscal Year Ended June 30, 1998

Exhibit A-7

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	Totals
Additions:							
Contributions:							
Employer.....	\$ 616,736	\$ 8,487	\$ 801	\$ —	\$ —	\$ 149,826	\$ 775,850
Plan members.....	488,212	2,466	257	2,781	—	180,474	674,190
Other contributions.....	—	—	—	11,735	2,533	—	14,268
Total contributions.....	<u>1,104,948</u>	<u>10,953</u>	<u>1,058</u>	<u>14,516</u>	<u>2,533</u>	<u>330,300</u>	<u>1,464,308</u>
Investment Income:							
Investment earnings.....	6,512,033	48,109	3,662	35,162	6,355	1,607,972	8,213,293
Less investment expenses.....	(161,473)	(1,207)	(100)	(853)	(167)	(41,641)	(205,441)
Net investment income.....	<u>6,350,560</u>	<u>46,902</u>	<u>3,562</u>	<u>34,309</u>	<u>6,188</u>	<u>1,566,331</u>	<u>8,007,852</u>
Fees, licenses and fines.....	—	—	—	—	—	4,590	4,590
Miscellaneous additions.....	1,379	—	—	2	—	18	1,399
Total additions.....	<u>7,456,887</u>	<u>57,855</u>	<u>4,620</u>	<u>48,827</u>	<u>8,721</u>	<u>1,901,239</u>	<u>9,478,149</u>
Deductions:							
Administrative expense.....	4,531	40	4	354	19	1,617	6,565
Benefits.....	1,369,233	11,260	945	12,262	1,703	265,793	1,661,196
Refund of contributions.....	73,855	106	17	322	—	50,698	124,998
Total deductions.....	<u>1,447,619</u>	<u>11,406</u>	<u>966</u>	<u>12,938</u>	<u>1,722</u>	<u>318,108</u>	<u>1,792,759</u>
Net increase (decrease)	6,009,268	46,449	3,654	35,889	6,999	1,583,131	7,685,390
Fund balance reserved for employees' pension benefits							
Beginning of the year (Note 16)...	<u>33,044,893</u>	<u>244,244</u>	<u>18,859</u>	<u>178,378</u>	<u>32,229</u>	<u>8,130,686</u>	<u>41,649,289</u>
End of year.....	<u>\$39,054,161</u>	<u>\$ 290,693</u>	<u>\$ 22,513</u>	<u>\$ 214,267</u>	<u>\$ 39,228</u>	<u>\$ 9,713,817</u>	<u>\$49,334,679</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

**INVESTMENT TRUST FUND
STATEMENT OF NET ASSETS**

June 30, 1998

Exhibit A-8

(Dollars in Thousands)

	<i>Investment Trust Fund</i>
ASSETS	
Cash and cash equivalents.....	\$ 3,959
Investments.....	509,527
Receivables:	
Interest receivable.....	4,063
Total Assets.....	<u>517,549</u>
LIABILITIES	
Obligations under	
securities lending.....	209,485
Distributions payable.....	1,454
Total Liabilities.....	<u>210,939</u>
NET ASSETS	
Held in trust for	
pool participants.....	<u><u>\$ 306,610</u></u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

INVESTMENT TRUST FUND
STATEMENT OF CHANGES IN NET ASSETS

For the Fiscal Year Ended June 30, 1998

*Exhibit A-9**(Dollars in Thousands)*

	<i>Investment Trust Fund</i>
Net increase in net assets resulting from operations:	
Revenues:	
Investment income.....	\$ 27,083
Expenses:	
Investment expenses.....	9,590
Net increase in net assets resulting from operations.....	17,493
Distributions to participants:	
Distributions paid and payable.....	(17,493)
Share transactions:	
Reinvestment of distributions.....	17,424
Net share purchases/(redemptions).....	3,806
Total increase in net assets.....	21,230
Net assets:	
Beginning of the year (Note 16).....	285,380
End of the year.....	\$ 306,610

The accompanying Notes to the Financial Statements are an integral part of this statement.

COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS **COMBINED STATEMENT OF CHANGES IN FUND EQUITY**

For the Fiscal Year Ended June 30, 1998

Exhibit A-10

*(Dollars in Thousands)***Revenues and Other Additions:**

Tuition and fees.....	\$ 404,072
Federal appropriations.....	21,937
County appropriations.....	112,378
Federal contracts and grants.....	600,400
State contracts and grants.....	78,231
Local contracts and grants.....	45,108
Private gifts, contracts and grants.....	298,905
Endowment income.....	21,052
Sales and services.....	821,839
Investment earnings.....	175,092
Expended for plant facilities.....	460,016
Retirement of indebtedness.....	26,250
Proceeds of refunding debt.....	75,113
Income from hospital operations.....	470,579
Other revenues and additions.....	46,256
Total Revenues and Other Additions.....	<u>3,657,228</u>

Expenditures and Other Deductions:

Educational and general.....	3,390,568
Auxiliary enterprises.....	474,293
Internal service.....	33,991
Independent operations.....	12,060
Professional clinical services.....	208,085
Indirect cost recovered.....	86,050
Refunded to grantors.....	866
Administrative and collection costs, loan cancellation and bad debts.....	2,457
Expended for plant facilities.....	407,768
Retirement of indebtedness.....	25,848
Payment to escrow agent.....	75,125
Interest on indebtedness.....	36,298
Disposal of plant facilities.....	60,721
Loss on refunding of debt.....	4,822
Hospital operations.....	405,958
Other expenditures and deductions.....	4,785
Total Expenditures and Other Deductions.....	<u>5,229,695</u>

Transfers-Additions (Deductions):

Operating transfers from primary government.....	2,273,875
Operating transfers to primary government.....	(16,572)
Operating transfers to component units.....	(9,531)
Net transfers.....	<u>2,247,772</u>
Net increase in fund equity.....	675,305
Fund equity — July 1 (Note 16).....	7,178,460
Restatements (Note 16).....	(4,273)
Residual equity transfers in (Note 17).....	739
Residual equity transfers out (Note 17).....	(793)
Fund equity — June 30.....	<u>\$ 7,849,438</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

COMPONENT UNITS — COLLEGE AND UNIVERSITY FUNDS
COMBINED STATEMENT OF CURRENT FUNDS
REVENUES, EXPENDITURES AND TRANSFERS

For the Fiscal Year Ended June 30, 1998

Exhibit A-11

(Dollars in Thousands)

Revenues:

Tuition and fees.....	\$ 402,155
Federal appropriations.....	21,937
County appropriations.....	90,734
Federal contracts and grants.....	515,884
State contracts and grants.....	70,127
Local contracts and grants.....	5,857
Private gifts, contracts and grants.....	211,107
Endowment income.....	21,867
Sales and services.....	821,916
Investment earnings.....	66,171
Other revenues.....	34,078
Total Current Revenues.....	<u>2,261,833</u>

Expenditures:

Educational and general:

Instruction.....	1,515,443
Organized research.....	368,829
Public service.....	237,278
Academic support.....	238,274
Student services.....	123,924
Institutional support.....	363,297
Physical plant operations.....	268,533
Student financial aid.....	274,989
Total educational and general.....	<u>3,390,567</u>
Auxiliary enterprises.....	474,293
Internal service.....	33,991
Independent operations.....	12,060
Professional clinical services.....	208,085
Total Expenditures.....	<u>4,118,996</u>

Transfers and Additions (Deductions):

Excess of restricted receipts over transfers to revenues.....	15,868
Refund to grantors.....	(856)
Mandatory transfers.....	(61,173)
Non-mandatory transfers.....	(13,970)
Interinstitutional transfers.....	(4,323)
Operating transfers from primary government.....	1,998,719
Operating transfers to primary government.....	(1,336)
Operating transfers to component units.....	(9,531)
Net increase in fund equity.....	<u>\$ 66,235</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

The accompanying financial statements of the State of North Carolina financial reporting entity have been prepared in conformity with generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board (GASB), which consist of GASB Statements and Interpretations, as well as American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local governmental entities by GASB Statements and Interpretations. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the State does not apply FASB pronouncements issued after November 30, 1989 for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date. The financial statements of the college and university funds have been prepared in conformity with generally accepted accounting principles for colleges and universities as prescribed by GASB Statement No. 15, *Governmental College and University Accounting and Financial Reporting Models*. The financial statements of the North Carolina Railroad Company (Railroad), a for-profit corporation (*discretely presented proprietary component unit*), have been prepared based on FASB pronouncements. The Railroad's financial statements have been incorporated into the State's reporting entity based on the definition and display provisions of GASB Statement No. 14, *The Financial Reporting Entity*.

The financial statements are presented as of and for the fiscal year ended June 30, 1998, except for the USS North Carolina Battleship Commission whose statements are as of and for the fiscal year ended September 30, 1997, and the North Carolina Deferred Compensation Plan, the 401(k) Supplemental Retirement Income Plan, and the North Carolina Railroad Company whose statements are as of and for the fiscal year ended December 31, 1997. Occupational licensing boards have financial statements with various fiscal year ending dates.

B. Financial Reporting Entity

The financial reporting entity includes (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) organizations for which the nature and significance of their relationships with the primary government are such that exclusion would cause the primary government's financial statements to be misleading or incomplete.

The State of North Carolina, as primary government, consists of all organizations that make up its legal entity. All funds, organizations, agencies, boards, commissions, and authorities that are not legally separate are, for financial reporting purposes, part of the primary government. The primary government has a separately elected governing body (the General Assembly) and the primary government must be both legally separate and fiscally independent. Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on, the State. The State has applied the criteria outlined in GASB Statement No. 14, *The Financial Reporting Entity*, in determining financial accountability.

As required by generally accepted accounting principles, these financial statements present the State (the primary government) and its component units. The component units are included in the financial reporting entity because of the significance of their operational or financial relationships with the State, as described below.

Blended Component Units**Comprehensive Major Medical Plan**

The Comprehensive Major Medical Plan (Plan) is a component unit that provides medical benefits to employees and retirees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has corporate powers and is governed by a board whose members are appointed by either the Governor or the General Assembly. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education. The Plan has been included in the financial statements using the blending method (internal service fund) because it almost exclusively benefits the primary government. Even though a substantial number of covered participants are not employees of the primary government, the Plan essentially serves only the primary government by managing the risk associated with providing health insurance to eligible employees. The other employers in the Plan do not have risk since the primary government is responsible for funding the premiums of all covered employees.

Disability Income Plan of North Carolina

NOTES TO THE FINANCIAL STATEMENTS

The Disability Income Plan of North Carolina (Plan) is a component unit that provides disability benefits to employees of the State, most of its component units, and local boards of education that are not part of the reporting entity. The Plan has corporate powers and is governed by a fourteen-member board. Ten members are appointed by the Governor, two are appointed by the General Assembly, and two are elected State officials. Provisions and contribution rates are approved by the General Assembly, with the State making significant contributions as an employer and through its funding of local boards of education. The Plan has been included in the financial statements using the blending method (internal service fund) because it almost exclusively benefits the primary government. Even though a substantial number of covered participants are not employees of the primary government, the Plan essentially serves only the primary government by managing the risk associated with providing disability insurance to eligible employees. The other employers in the Plan do not have risk since the primary government is responsible for funding the premiums of all covered employees.

Discretely Presented Component Units

The component units columns in the combined financial statements include the financial data of the following organizations. They are reported as either college and university funds or proprietary funds.

College and University Funds

University of North Carolina System

The Board of Governors of the consolidated University of North Carolina (UNC) system is a legally separate body, composed of thirty-two members elected by the General Assembly. The Board of Governors establishes system-wide administrative policies while budgetary decisions are exercised at the State level. Within the consolidated system there is UNC-General Administration, which is the administrative arm of the Board of Governors, the sixteen constituent universities, and UNC Hospitals. Each of the sixteen universities, in turn, is governed by its own separate board of trustees that is responsible for the operations of that campus only. UNC Hospitals is governed by a separate board of directors. Funding for each of the institutions of the UNC system is accomplished by State appropriations, tuition and fees, sales and services, federal grants, and private donations and grants.

The following constituent institutions comprise the UNC system for financial reporting purposes:

Appalachian State University
East Carolina University
Elizabeth City State University
Fayetteville State University

North Carolina Agricultural and Technical State University
North Carolina Central University
North Carolina School of the Arts
North Carolina State University
University of North Carolina at Asheville
University of North Carolina at Chapel Hill
University of North Carolina at Charlotte
University of North Carolina at Greensboro
University of North Carolina at Pembroke
University of North Carolina at Wilmington
Western Carolina University
Winston-Salem State University
UNC Hospitals

Community Colleges

There are currently fifty-eight community colleges located throughout the State of North Carolina. Each is a separate component unit of the reporting entity and is legally separate. The State does not appoint a voting majority of each community college board of trustees. The State Board of Community Colleges (the Board) approves the budgeting of state and federal funds, the associated budget revisions, and the selection of the chief administrative officer of each individual community college. The Board is comprised of state officials or their appointees. Each community college is similar in nature and function to all of the others, and the operations of no community college is considered major in relation to the operations of all community colleges in the system. Therefore, aggregated financial information is presented in this CAFR for all community colleges. The following are the State's fifty-eight community colleges:

Alamance Comm. College	Anson Comm. College
Asheville-Buncombe	Beaufort County Comm. College
Technical Comm. College	Blue Ridge Comm. College
Bladen Community College	Caldwell Comm. College
Brunswick Comm. College	and Technical Institute
Cape Fear Comm. College	Carteret Comm. College
Catawba Valley Comm. College	Central Piedmont Comm. College
Central Carolina Comm. College	Cleveland Comm. College
Coastal Carolina Comm. College	College of The Albemarle
Craven Comm. College	Durham Technical Comm. College
Davidson County Comm. College	Fayetteville Technical Comm. College
Edgecombe Comm. College	Forsyth Technical Comm. College
Gaston College	Guilford Technical Comm. College
Halifax Comm. College	Haywood Comm. College
Isothermal Comm. College	James Sprunt Comm. College
Johnston Comm. College	Lenoir Comm. College
Martin Comm. College	Mayland Comm. College
McDowell Technical Comm. College	Mitchell Comm. College
Montgomery Comm. College	Nash Comm. College
Pamlico Comm. College	Piedmont Comm. College
Pitt Comm. College	Randolph Comm. College
Richmond Comm. College	Roanoke-Chowan Comm. College

NOTES TO THE FINANCIAL STATEMENTS**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

Robeson Comm. College	Rockingham Comm. College
Rowan-Cabarrus Comm. College	Sampson Comm. College
Sandhills Comm. College	Southeastern Comm. College
Southwestern Comm. College	Stanly Comm. College
Surry Comm. College	Tri-County Comm. College
Vance-Granville Comm. College	Wake Technical Comm. College
Wayne Comm. College	Western Piedmont Comm. College
Wilkes Comm. College	Wilson Technical Comm. College

Proprietary Funds**North Carolina Housing Finance Agency**

The North Carolina Housing Finance Agency is a legally separate organization established to administer programs to finance construction of low and moderate income housing. The Agency has a thirteen-member board of directors, with twelve appointed by either the Governor or the General Assembly. The thirteenth member is elected by the other twelve. The State can significantly influence the programs, projects, activities, and level of services of the Agency.

State Education Assistance Authority

The State Education Assistance Authority is a legally separate authority created to provide a system of financial assistance, consisting of grants, loans, work-study or other employment, and other aids, to qualified students to obtain an education beyond the high school level by attending public or private educational institutions. The Authority is governed by a seven-member board of directors, all of whom are appointed by the Governor. The State provides significant operating subsidies to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

North Carolina State Ports Authority

The North Carolina State Ports Authority is a legally separate authority established to operate the State's port facilities in Wilmington and Morehead City. It is governed by an eleven-member board, all of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

Centennial Authority

The Centennial Authority is a legally separate authority created to study, design, plan, construct, own, promote, finance and operate a regional facility in Wake County, North Carolina. The regional facility, will consist of an arena, coliseum or other buildings or both, where sports, fitness, health, recreational, entertainment or cultural activities can be conducted. The Authority is governed by a thirteen-member board comprised of eight members appointed by the General Assembly; two members appointed by the Wake County Board of Commissioners; two members appointed by the Raleigh City Council; and one member appointed jointly by the mayors of all the cities of Wake County. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Railroad Company

The North Carolina Railroad Company is a legally separate, for-profit corporation owned by the State for the purpose of promoting trade, industry, and transportation within the State of North Carolina and advancing the economic interests of the State. The Railroad is governed by a 14 member board, all of whom are elected by shares held by the State. A financial benefit/burden relationship exists between the State and the Railroad.

North Carolina Global TransPark Authority

The North Carolina Global TransPark Authority (formerly North Carolina Air Cargo Airport Authority) is a legally separate authority created to administer the development of the North Carolina Global TransPark. Of the twenty-member governing board, nineteen are voting members. Seven of the voting members are appointed by the Governor and six are appointed by the General Assembly. The State has obligated itself to provide significant funding to the Authority for years to come; therefore, a financial benefit/ burden relationship exists between the State and the Authority.

NOTES TO THE FINANCIAL STATEMENTS**North Carolina Low Level Radioactive Waste Management Authority**

The North Carolina Low Level Radioactive Waste Management Authority is a legally separate authority created to locate, construct and operate a regional site for the disposal of low level radioactive waste. The Authority is governed by a fifteen-member board, all of whom are appointed by either the Governor or the General Assembly. The State has the ability to influence the budget, programs, and activities of the Authority.

MCNC

MCNC (formerly the Microelectronics Center of North Carolina) is a legally separate nonprofit corporation created to foster advanced programs in microelectronics and super-computing, in support of economic development and of North Carolina universities and research institutes. Of the sixteen-member governing board, eleven are voting members. Seven of the voting board members are appointed by the Governor and four serve as a result of their positions with the UNC system, a component unit of the State. The State has provided significant funding to the organization since its inception; therefore, a financial benefit/burden relationship exists between the State and the organization.

North Carolina Biotechnology Center

The North Carolina Biotechnology Center is a legally separate nonprofit corporation created to further economic development through the support of biotechnology research. The Center is governed by a thirty-five-member board. Fifteen of the board members are appointed by the Governor or General Assembly and four serve as a result of their positions with the UNC system, a component unit of the State. The State has provided significant funding to the Center since its inception; therefore, a financial benefit/burden relationship exists between the State and the Center.

North Carolina Rural Economic Development Center, Inc.

The North Carolina Rural Economic Development Center is a legally separate organization established to build economic strength in the State's 85 rural counties, with a special focus on creation of economic opportunities for citizens with low to moderate incomes. The Center has a 48 member board of directors, with three appointed by the Governor, three by the Lieutenant Governor, and three by the Speaker of the House. The other members are elected by the appointed members of the board of directors. The State provides significant program and operating support to the Center creating a benefit/burden relationship.

Other Proprietary Component Units:**North Carolina Agricultural Finance Authority**

The North Carolina Agricultural Finance Authority is a legally separate authority created to administer the financing of low-interest loans to farmers. The Authority is governed by a ten-member board, one of whom is a state official and nine of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Partnership for Children, Inc.

The North Carolina Partnership for Children, Inc., is a legally separate organization established to develop a comprehensive long-range strategic plan for early childhood development. A thirty-three-member board governs the Partnership. Certain elected state officials appoint twenty-nine of the members, while four members serve ex officio by virtue of their state positions. The State provides significant operating subsidies to the Partnership creating a benefit/burden relationship.

North Carolina Ports Railway Commission

The North Carolina Ports Railway Commission is a legally separate organization established to operate, maintain and control all railway equipment and railway operations transferred to it by the North Carolina State Ports Authority in January 1981. The Commission is governed by a five-member board, all of whom are appointed by the Governor. A financial benefit/burden relationship exists between the State and the Commission.

North Carolina Regional Economic Development Commissions:**Northeastern North Carolina Regional Economic Development Commission**

The Northeastern North Carolina Regional Economic Development Commission is a legally separate organization created to facilitate economic development and tourism in northeastern North Carolina. The Commission consists of 17 members, including the Secretary of Commerce and the Secretary of the Department of Environment and Natural Resources (or their designees), five members appointed by the Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****Southeastern North Carolina Regional Economic Development Commission**

The Southeastern North Carolina Regional Economic Development Commission is a legally separate organization created to build economic strength in southeastern North Carolina. The Commission consists of 15 members, with three appointed by the Governor, two by the Lieutenant Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Western North Carolina Regional Economic Development Commission

The Western North Carolina Regional Economic Development Commission is a legally separate organization created to improve economic opportunity in western North Carolina with sensitivity to the resources of that region. The Commission consists of 15 members, with five appointed by the N.C. House of Representatives, five by the N.C. Senate, three by the Governor, and two by the Lieutenant Governor. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

North Carolina Rural Rehabilitation Corporation

The North Carolina Rural Rehabilitation Corporation is a legally separate nonprofit corporation created to assist individuals and families in rural areas of the state. The Corporation is governed by a nine-member board, all of whom are appointed by the Governor or serve by virtue of their positions as state officials. The State has the ability to influence the budget, programs, and activities of the Corporation.

Complete financial statements for the following component units can be obtained from the Office of the State Auditor, 300 N. Salisbury Street, Raleigh, N.C. 27603-5903.

University of North Carolina System
Community colleges
North Carolina State Ports Authority
North Carolina Global TransPark Authority
North Carolina Low Level Radioactive Waste Management Authority
North Carolina Partnership for Children, Inc.
North Carolina Ports Railway Commission

Complete financial statements of the remaining component units, examined by independent auditors, can be obtained from the respective administrative offices of those units, listed below:

N.C. Housing Finance Agency P.O. Box 28066 Raleigh, NC 27611-8066	Centennial Authority 1520 Blue Ridge Road, Suite 201 Raleigh, North Carolina 27607
State Education Assistance Authority P.O. Box 2688 Chapel Hill, NC 27515-2688	MCNC P.O. Box 12889 Research Triangle Park, NC 27709-2889
N.C. Biotechnology Center P.O. Box 13547 Research Triangle Park, NC 27709-3547	North Carolina Railroad Company 3200 Atlantic Avenue, Suite 110 Raleigh, NC 27604-1640
Western N.C. Regional Economic Development Commission P.O. Box 1258 Arden, NC 28704	N.C. Rural Economic Development Center, Inc. 4021 Carya Drive Raleigh, NC 27610
Northeastern N.C. Regional Economic Development Commission P.O. Box 29 Edenton, NC 27932	Southeastern N.C. Regional Economic Development Commission P.O. Box 2556 Elizabethtown, NC 28337

The North Carolina Agricultural Finance Authority and the North Carolina Rural Rehabilitation Corporation do not issue separate financial statements.

C. Fund Accounting

The financial activities of the State and its component units are organized on a basis of individual funds and account groups, each of which is a separate accounting entity segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations, restrictions, or limitations. The financial activities of the State and its component units accounted for in the accompanying financial statements have been classified into the following fund categories and account groups:

1. Primary Government (the State)***Governmental Funds***

Governmental funds are those through which most governmental functions of the State are financed. The acquisition, use, and balances of the primary government's expendable financial resources and the related liabilities (except those accounted for in proprietary funds) are accounted for through governmental funds. The measurement focus is upon determination of financial position and changes in financial position (sources, uses, and balances of financial resources) rather than upon net income determination. The following are the State's governmental funds.

NOTES TO THE FINANCIAL STATEMENTS

General Fund.

All financial resources received and used for services traditionally provided by a state government and not required to be accounted for in other funds are accounted for in the General Fund. These services include general government; education (other than universities and community colleges); health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; and agriculture.

Special Revenue Funds.

Transactions related to resources obtained from specific revenue sources (other than for expendable trusts or major capital projects) that are legally restricted to expenditures for specific purposes are accounted for in special revenue funds. The special revenue funds reported in this CAFR have been grouped under the following governmental functional categories: transportation; general government; education (other than universities and community colleges); health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; and agriculture.

Capital Projects Funds.

Transactions related to resources obtained and used for the acquisition, construction, or improvement of major governmental general fixed assets are accounted for in the capital projects funds. Such resources are derived principally from operating transfers from the General Fund and from bond funds. Highway infrastructure construction projects are accounted for in the State Highway Fund and the Highway Trust Fund. These projects are not included in the capital projects funds.

Proprietary Funds

Proprietary funds are used to account for the State's ongoing activities which are similar to those often found in the private sector. The measurement focus is upon determination of net income, financial position, and changes in cash flows. The generally accepted accounting principles used are those applicable to similar businesses in the private sector; thus, these funds are reported on the accrual basis of accounting. The following are the State's proprietary funds.

Enterprise Funds.

Enterprise funds account for operations of the State that are financed and operated in a manner similar to private business enterprises. The costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis are financed or recovered primarily through user charges. The acquisition, maintenance, and improvement of physical plant facilities required to provide these goods and services are financed from existing cash resources, the issuance of bonds, federal grants, and other State funds.

Internal Service Funds.

Internal service funds account for the operations of State agencies that provide services to other State agencies, departments, or other governmental units on a cost reimbursement basis.

Fiduciary Funds

Fiduciary funds are used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. The following are the primary government's fiduciary funds.

Trust Funds.

- **Expendable Trust.** Expendable trust funds account for assets held by the State in a trustee capacity where the principal and income may be expended in the course of the funds' designated operations.
- **Nonexpendable Trust.** Nonexpendable trust funds account for assets held by the State in a trustee capacity where only income derived from the principal may be expended in the course of the funds' designated operations. The principal must be preserved intact.
- **Pension Trust.** Pension trust funds account for transactions, assets, liabilities, and net assets available for plan benefits of the various State and local governmental public employee retirement systems which the State administers.
- **Investment Trust.** The investment trust fund accounts for the external portion of the Investment Pool sponsored by the State Treasurer.

Agency Funds.

Agency funds account for the various taxes, deposits, deductions, and property collected by the State, acting in the capacity of an agent, for distribution to other governmental units or designated beneficiaries.

Account Groups

Account groups are used to establish accounting control and accountability for the State's general fixed assets and general long-term obligations and do not involve measurement of operations.

General Fixed Assets Account Group.

This account group is established to account for fixed assets acquired for general government purposes, except those accounted for in proprietary funds or college and university funds. General fixed assets do not represent financial resources available for appropriation and expenditure.

General Long-Term Obligations Account Group.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

This account group is established to account for the unmatured principal of the State's general long-term debt and other long-term obligations of governmental funds. The unmatured principal of general long-term debt and other long-term obligations does not require current appropriation and expenditure of governmental fund financial resources.

2. Component Units

Proprietary Funds

Proprietary funds are used to account for the various component units' ongoing activities which are similar to those often found in the private sector, as well as those within the primary government described above.

College and University Funds

College and university funds account for the operations of the UNC system and community colleges in accordance with existing authoritative accounting and reporting principles applicable to colleges and universities. Presentation of the underlying fund groups of the individual universities and community colleges is available from each respective institution's separately issued financial statements.

D. Basis of Accounting

The basis of accounting determines when revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities are generally included on the balance sheet. Operating statements of these funds present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

All proprietary funds, nonexpendable trust, and pension trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of proprietary funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings. Proprietary funds' and similar trust funds' operating statements present increases (revenues) and decreases (expenses) in net total assets.

1. Governmental Funds, Expendable Trust Funds and Agency Funds

The accounts of the general, special revenue, capital projects, expendable trust, and agency funds are reported using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at fiscal year-end. The State considers amounts to be available if due within 31 days of the close of the fiscal year. Expenditures and other uses of financial resources are recognized when the related liability is incurred, except for items that are not planned to be liquidated with expendable available resources, such as the long-term portion of the liability for compensated absences and capital lease obligations.

Other modifications to the accrual basis of accounting include the following:

- inventories generally are considered expenditures at acquisition;
- prepayments usually are not capitalized; and
- principal and interest on long-term debt are recorded when due.

2. Proprietary Funds, Nonexpendable Trust Funds and Pension Trust Funds

The accounts of the enterprise, internal service, nonexpendable trust, pension trust funds, and proprietary component units are reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

3. College and University Funds

The accounts of the college and university funds are reported using the accrual basis of accounting with the following exceptions:

- Depreciation expense related to plant fund assets is not recorded; and
- Revenues and expenditures of an academic term encompassing more than one fiscal year are reported solely in the fiscal year in which the program is predominantly conducted.

E. Cash and Cash Equivalents

This classification appears on the accompanying combined balance sheet, combining statement of pension plan net assets, investment trust fund statement of net assets, and combined statement of cash flows. It includes deposits held by the State Treasurer in certain short-term investment portfolios more fully discussed in Note 4, investment of bond proceeds, demand deposits with private financial institutions, and cash on hand. The short-term investment portfolios maintained by the State Treasurer have the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without

NOTES TO THE FINANCIAL STATEMENTS

prior notice or penalty. Bond proceeds are invested in highly liquid securities with an original maturity of 3 months or less.

F. Investments

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios more fully discussed in Note 4 as well as investments held separately by the State and its component units. It also includes each participating fund and component unit's share of the cash collateral received and invested by the State Treasurer under securities lending agreements. During the year the State reassessed which funds and component units bear the risk of loss on the collateral assets. This significantly affected the assets and liabilities reported by the individual funds and component units. Investments are generally valued at fair value. Additional investment valuation information is provided in Note 4.

The classification does not include any of the reporting entity's accounts that would be defined as cash equivalents based on GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

G. Deposit with Federal Government

This classification consists of unemployment compensation trust funds (expendable trust fund) held on deposit in the Federal Reserve Bank of the United States Treasury.

H. Receivables and Due from Other Funds

Receivables in governmental and fiduciary funds consist primarily of tax, interest, and federal revenues. Receivables in proprietary and college and university funds occur in the normal course of business. The "Due from other funds" classification represents interfund receivables consisting of transactions between fund types within the State (primary government). Operating transfers, quasi-external transactions, and reimbursements are classified in this account. All receivables are shown net of allowances for doubtful accounts.

I. Advances to Other Funds

Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset by a fund balance reserve account which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

J. Inventories

The inventories of the State and proprietary component units are valued on the first-in, first-out, last invoice cost, or average cost basis. These inventories consist of general supplies and materials. Institutions of the UNC system and community colleges also use these valuations along with the retail inventory method for some bookstore operations. The State Highway Fund (special revenue fund) accounts for its maintenance and construction inventories using the average cost basis. Inventories of all proprietary funds are valued by the first-in, first-out method or average cost basis.

Except for the State Highway Fund's maintenance and construction inventories, the cost of inventory items in the State's governmental funds is recorded as an expenditure when purchased. Reported inventories are equally offset by a fund balance reserve that indicates they do not constitute "available spendable resources" even though they are a part of net current assets. All other inventories of the State and its component units are recognized as expenses or expenditures when consumed.

K. Food Stamps

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the State recognizes distributions of food stamp benefits as revenue and expenditures in the general fund, whether the benefits are distributed directly or through agents and whether the benefits are in paper or electronic form. Expenditures are recognized when the benefits are distributed to the individual recipients by the State or its agents; revenue is recognized at the same time. The State reports food stamp balances held by the State or by its agents at the balance sheet date as an asset offset by deferred revenue. Revenue, expenditures, and balances of food stamps are measured based on face value.

L. Fixed Assets

General fixed assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions and construction are reflected as expenditures in governmental funds, and the related assets are reported in the general fixed assets account group. For financial reporting purposes, depreciation is not recorded on general fixed assets. Fixed assets of all proprietary funds are capitalized in the fund in which they are utilized and are depreciated either on the straight-line basis or on the units of output basis over their useful lives. Fixed assets of the UNC system and community colleges are capitalized in college and university funds. Depreciation is not reported on these assets.

Fixed assets are stated at historical cost, or in some instances, estimated historical cost. Donated fixed assets are

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

stated at fair market value at the time of donation. The State (except for the USS N.C. Battleship Commission), some proprietary component units, and the college and university component units capitalize all fixed assets that have a value or cost greater than or equal to \$5,000 at the date of acquisition and have an expected useful life of two or more years. Certain proprietary component units (N.C. Housing Finance Agency, N.C. State Ports Authority, N.C. Railroad Company, N.C. Global TransPark Authority, N.C. Biotechnology Center, N.C. Partnership for Children, Northeastern N.C. Regional Economic Development Commission, Southeastern N.C. Regional Economic Development Commission, Western N.C. Regional Economic Development Commission, N.C. Rural Economic Development Center) and the USS N.C. Battleship Commission (an enterprise fund) maintain a minimum threshold of \$500. Occupational licensing boards use various thresholds to capitalize fixed assets.

The value of assets constructed by the State and its component units for their own use includes all material direct and indirect construction costs that are increased as a result of the construction. In proprietary funds and component units, interest costs incurred (if material) are capitalized during the period of construction.

Public domain ("infrastructure") general fixed assets consisting of highways, bridges, highway lands, and rights-of-way are not capitalized.

The depreciation methods and estimated lives used by proprietary funds are:

	<u>Method</u>	<u>Estimated Useful Life</u>
Buildings	Straight-line	7-50 years
Other structures and improvements	Straight-line	10-50 years
Machinery and	Straight-line	3-15 years
equipment	Units of output for motor vehicles	90,000 miles/ vehicle

M. Tax Refund Liabilities

Tax refund liabilities consist primarily of accrued income and sales and use tax refunds due to taxpayers. During the calendar year, the State collects employee withholdings and taxpayers' payments for income taxes. At June 30, the State estimates the amount it owes taxpayers for income tax overpayments during the preceding six months. Sales and use tax refund liabilities are also estimated at June 30. These liabilities are recorded as "Tax refunds payable".

N. Obligations Under Securities Lending

In accordance with GASB Statement No. 28, liabilities resulting from securities lending transactions are reported on the combined balance sheet.

O. Retiree and Intangibles Tax Judgements Payable

Retiree tax judgement liabilities consist of amounts due to retired federal and State employees as a result of court rulings against the State in the *Bailey* and *Patton* cases. Intangibles tax judgement liabilities are the result of court rulings against the State in the *Smith* and *Patton* cases.

P. Lease Obligations

Assets acquired under capital leases are generally valued at the present value of the lease payments. Capital leases of governmental funds are reported in the general long-term obligations account group and the related assets are reported in the general fixed assets account group. Capital leases for proprietary funds and college and university funds are reported in those funds, along with the related assets.

GASB Codification Section L20 and the Statement of Financial Accounting Standards No. 13, *Accounting for Leases*, issued by the Financial Accounting Standards Board (FASB), establish requirements for lease obligations. Leases meeting the standards of FASB 13 have been capitalized and are reported as capital leases payable. Other leases are accounted for as operating leases and are not recorded on the balance sheet. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. Refer to Note 6 for specific disclosures on lease obligations.

All leases of the State contain appropriation clauses indicating that continuation of the lease is subject to continued funding by the Legislature. For reporting purposes, leases are fully disclosed since cancellation due to lack of appropriation is deemed unlikely.

Q. Compensated Absences

The State and its component units have adopted the accounting and reporting principles outlined in GASB Codification Section C60 regarding employee vacation leave. Since unpaid vacation leave will not be liquidated with expendable available financial resources, the State's liability for long-term accumulated unpaid vacation leave is reported in the accompanying general long-term obligations account group for all governmental funds. There is no liability in the accompanying financial statements for unpaid accumulated sick leave because the State has no obligation to pay sick leave upon employee termination or retirement.

NOTES TO THE FINANCIAL STATEMENTS

In the proprietary funds and college and university funds, the liability for accumulated unpaid vacation leave is reported as a current liability. For the same reasons as cited for governmental funds, no liability for unpaid accumulated sick leave is recorded.

In governmental funds, the expenditure for compensated absences (vacation and sick leave) is recorded when the leave is taken. In proprietary funds the expense for vacation leave is recorded when the leave is earned. In college and university funds a year-end adjustment is recorded to reflect the current year's vacation leave expense. The expense for sick leave is recorded when the leave is taken in both proprietary and college and university funds.

The State's policy on compensated absences is generally adhered to by its agencies, departments, and most of its component units. Full-time permanent, probationary and trainee employees earn vacation leave ranging from 0.98 to 2.15 days per month, depending upon years of service. Part-time employees earn the same range of leave on a pro-rata amount based on the number of hours a week they work. There is no requirement that vacation leave be taken, but the maximum permissible accumulation is 30 days. Any vacation accumulated beyond 30 days is converted to sick leave at year end. At termination, employees are paid for any accumulated vacation leave. Full-time permanent, probationary and trainee employees earn sick leave at the rate of one day per month with an unlimited accumulation. Part-time employees earn a percentage of the total of 8 hours per month based on the number of hours a week they work. Employees are not paid for accumulated sick leave upon termination; however, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

R. Long-Term Liabilities

Long-term liabilities expected to be financed from governmental funds are accounted for in the general long-term obligations account group. Expenditures for principal and interest payments are recognized in the respective fund type when due. Long-term liabilities expected to be financed from the proprietary funds and the college and university funds, as well as the related interest payments, are accounted for in those funds.

Capital appreciation bonds are those bonds that are issued at stated interest rates (which may be zero) significantly below their effective interest rate, resulting in a substantial discount (deep discount). The implicit interest (*i.e.*, discount) is not paid until the bonds mature. Therefore, the net value of the bonds accrete (*i.e.*, the discount is reduced) over the life of the bonds. This deep-discount debt is reported in the general long-term obligations account group at its net or accreted value rather than at face value.

S. Sureties

Sureties include various assets, including securities from insurance companies doing business within North Carolina, that have been placed in safekeeping with the State Treasurer, as required by applicable general statutes.

T. Fund Equity

Contributed capital is recorded in all proprietary funds that have received capital grants or contributions from other sources. Fund balance reserved (in governmental and trust funds) and fund balance restricted (in college and university funds) represent that portion of fund balances (1) not available for appropriation or expenditure and/or (2) that is legally segregated by outside third parties for a specific future use. Refer to Note 15 for disclosure on reserves. Designations of unreserved fund balance represent tentative management plans that are subject to change.

U. Revenues

Taxes.

Taxes, net of estimated refunds, are recognized as revenue when they become both measurable and available to finance expenditures of the fiscal period.

Federal Grant Revenues.

Federal grants are recorded as receivables and as revenues when the related expenditures are incurred. Grants received before the revenue recognition criteria have been met are reported as deferred revenue.

V. Interfund Transactions

During the course of normal operations there are numerous transactions between and within fund types of the State and its component units, including expenditures and transfers of resources to provide services, construct assets, and service debt. The accompanying financial statements generally reflect such transactions as operating transfers, except for retirement contributions made by the State and its component units, which are accounted for as revenues in the pension trust funds and expenditures/expenses in the contributing funds. In addition, proprietary funds (primarily internal service funds) record charges for services to all other funds as operating revenue. All funds record their payments to proprietary funds as expenditures/operating expenses. The balances at year-end resulting from these transactions are interfund receivables or payables and are classified as "Due to," "Due from," "Advance to," or "Advance from" on the Combined Balance Sheet. The composition of the State and its component units' interfund receivables and payables is presented in Note 8.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)****W. Implementation of GASB Pronouncements**

The State implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, and GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, for the fiscal year ended June 30, 1998. The implementation of GASB Statement No. 31 resulted in reporting certain investments at fair value rather than cost and reporting the external portion of the State's external investment pool in a new fund-type, an investment trust fund (previously reported as an agency fund).

The implementation of GASB Statement No. 32 resulted in reporting the State's Deferred Compensation Plan in an

expendable trust fund (previously reported as an agency fund). The Plan assets are now held in trust for the exclusive benefit of participants and their beneficiaries.

X. Totals - Memorandum Only

The "Totals - Memorandum Only" columns on the general purpose financial statements are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations, or cash flows in conformity with GAAP. Neither is the data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2: BUDGETARY ACCOUNTING AND REPORTING

A. Budgetary Process

The State of North Carolina operates on a biennial budget cycle with separate annual departmental certified budgets adopted by the General Assembly on the cash basis of accounting for the General Fund, the State Highway Fund, the Highway Trust Fund, certain special revenue funds, and capital projects funds. However, budgets adopted by the General Assembly based on annual State tax and non-tax revenues for the State Highway Fund and the Highway Trust Fund are combined with federal and local participation revenues and are primarily budgeted and accounted for on a multi-year project basis. Capital projects funds are budgeted on a project basis. Since these funds have multi-year project budgets, they are not included in the budgetary comparison statement.

The accompanying budgetary comparison statement discloses the annual "appropriated budget" for the General Fund and budgeted special revenue funds. Actual amounts in the statement are presented on the budgetary basis. Since the budgetary basis differs from generally accepted accounting principles (GAAP), a reconciliation between the budgetary basis and the GAAP basis is presented in Note 2 B.

The legal level of budgetary control is essentially at the object level. However, departments and institutions may make changes at their discretion within the budget of each purpose between and among objects for supplies and materials, current obligations and services, fixed charges and other expenses, and capital outlay. Also, Chapter 116, Article 1, Part 2A of the General Statutes authorized the sixteen universities within the University of North Carolina system to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions, primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management (OSBM). Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina system. All sixteen universities have applied for and received special responsibility status.

Generally, unexpended appropriations at the end of the fiscal year lapse and are reappropriated in the next fiscal year. However, in certain circumstances the OSBM will allow a department to carry forward appropriations for specifically identified expenditures that will be paid in the next fiscal year. This is accomplished by the department writing a check to itself and recording a budgetary expenditure. The check is deposited in the next fiscal year as a budgetary receipt.

Further detailed appropriation and departmental budget information is available for public inspection in the separately published "Budgetary Compliance Report" prepared by the Office of the State Controller, 3512 Bush Street, Raleigh, NC 27609-7509 and through the Office of State Budget and Management, 116 West Jones Street, Raleigh, NC 27603-8005.

B. Reconciliation of Budget/GAAP Reporting Differences

The *General Fund and Special Revenue Funds, Combined Statement of Revenues, Expenditures and Changes in Unreserved Fund Balances - Budget and Actual (Budgetary Basis - Non-GAAP)* - Exhibit A-3, presents comparisons of the legally adopted budget (which is more fully described in section A, above) with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly from those principles used to present financial statements in conformity with generally accepted accounting principles (GAAP). The following describes the major differences between budgetary financial data and GAAP financial data.

Entity differences. The State Highway Fund and the Highway Trust Fund, as discussed in section A, have multi-year budgets and therefore are not included in the budgetary statements. They are presented in the special revenue funds for GAAP purposes. Certain funds not included in the annual budgetary statements but which have the characteristics of governmental funds are presented in either the General Fund or the special revenue funds for GAAP purposes.

Basis differences. Budgetary funds are accounted for on the cash basis of accounting, while under GAAP the governmental funds use the modified accrual basis. Accrued revenues and expenditures are recognized in the GAAP financial statements.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2: BUDGETARY ACCOUNTING AND REPORTING (continued)

Timing differences. A significant variance between budgetary practices and GAAP is the authorized carryforward of appropriated funds, which is described in section A.

The following table presents a reconciliation of resulting entity, basis, and timing differences in the fund balances (budgetary basis) at June 30, 1998 to the fund balances on a modified accrual basis (GAAP). Amounts are expressed in thousands.

	<i>General Fund</i>	<i>Special Revenue Funds</i>
Unreserved fund balance (Exh. A-3, budgetary basis), June 30, 1998.....	\$ 515,230	\$ 258,441
Reserved fund balance (budgetary basis),		
Savings.....	522,521	—
Repairs and renovation.....	174,190	—
Retirees' health premium.....	231,682	—
Work First.....	19,541	—
NC Railroad acquisition.....	61,000	—
Disproportionate share.....	35,447	—
Clean Water Management Trust Fund.....	47,398	—
DPI allocation.....	55,028	—
Fund balance (budgetary basis).....	\$ 1,662,037	\$ 258,441
Reconciling Adjustments:		
Entity Differences:		
Primary government:		
State Highway Fund.....	—	126,236
Highway Trust Fund.....	—	911,496
Other.....	228,801	1,231,582
Component unit.....	—	(48,191)
Basis Differences:		
Accrued revenues.....	436,444	8,433
Accrued expenditures		
Retiree tax judgements.....	(400,000)	—
Other accrued expenditures.....	(605,886)	(14,877)
Other Adjustments:		
Advances to component units (net of budgetary reserves).....	33,054	—
Notes receivable.....	497	6,003
Inventories.....	48,997	5,388
Investments.....	43	—
Prepaid items.....	—	62
Timing Differences:		
Authorized carryforward of appropriated funds.....	260,663	—
Fund balance (Exh. A-2, GAAP basis) June 30, 1998.....	<u>\$1,664,650</u>	<u>\$2,484,573</u>

C. Budgetary Reserves

The North Carolina General Assembly has established several accounts in the General Fund as reserved fund balances for budgetary purposes. Funds that are transferred

to these accounts from the unreserved credit balance of the General Fund can be used only for their intended purposes and are not available for appropriation, except for the Savings Reserve Account which is not legally restricted for a specific future use.

Savings Reserve Account (G.S. 143-15.2 through 143-15.3B). One-fourth of any unreserved credit balance (budgetary basis) remaining in the General Fund at the end of each fiscal year will be transferred to the Savings Reserve account until the account contains funds equal to 5% of the amount appropriated the preceding year for the General Fund operating budget. On June 30, 1998, \$21.6 million was transferred into the Savings Reserve Account, bringing the total reserve to the 5% cap of \$522.5 million. Since this account is not legally restricted for a specific future use, it is reported as unreserved fund balance for GAAP purposes.

Retirees' Health Premiums Reserve. This reserve account was established to receive and temporarily retain employer contributions for retirees' health insurance premiums made by all State agencies and universities and by local governments that have employees who are members of the State Health Plan. The June 30, 1998 balance was \$231.7 million, which differs from the reserve amount in Note 15 due to the recognition of accrued revenues in the GAAP basis statements.

Repairs and Renovations Reserve Account (G.S. 143-15.2 through 143-15.3B). This reserve account provides for a portion of the State's continuing capital needs. The reserve balance is based on 3% of the estimated replacement value of all State buildings supported from the General Fund. The funds in this account shall be used only for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund. For fiscal year 1997-98, the General Assembly placed \$145 million into this reserve. The balance in the Repairs and Renovations Reserve at June 30, 1998 was \$174.2 million.

Clean Water Management Trust Fund (G.S. 143-15.2 through 143-15.3B). This reserve account provides for the Clean Water Management Trust Fund to finance projects to clean up or prevent surface water pollution as approved by the Clean Water Management Commission. The amount reserved in the General Fund each year is defined as 6.5% of any unreserved credit balance remaining in the General Fund at the end of the fiscal year, or \$30.0 million dollars, whichever is greater. For the 1997-98 fiscal year, \$47.4 million was placed in this reserve.

North Carolina Railroad Acquisition Reserve (1997 General Assembly, Senate Bill 352, Section 32.30). For fiscal year 1996-97, the General Assembly established the

NOTES TO THE FINANCIAL STATEMENTS

Railroad Reserve Account. In order to help promote trade, industry, and transportation within the State of North Carolina and to advance the economic interests of the State and its citizens, the General Assembly found it advantageous for the State to acquire the outstanding shares of the North Carolina Railroad Company not held by the State. On April 1, 1998 the General Fund loaned the North Carolina Railroad Company \$61 million for the retirement of non-State owned common stock shares of the Railroad. The \$61 million will remain in reserve until the related debt is satisfied. At June 30, 1998, the balance in the reserve was \$61 million.

Department of Public Instruction (DPI) Allocation (Session Law 1998-23, Section 5). For the fiscal year 1997-98, the General Assembly reserved \$55 million of unexpended General Fund appropriations to be used to fund public school employee performance bonuses, longevity payments, school bus purchases, and purchase of additional school technology.

Disproportionate Share Reserve Account (1997 General Assembly, Senate Bill 352, Section 11). Disproportionate share payments are Medicaid payments made to hospitals which serve a disproportionate share of indigent patients. This account was established to reserve for future appropriation any excess collection of disproportionate share revenues above those budgeted as departmental receipts or non-tax revenues. There was \$35.4 million in this reserve at June 30, 1998.

Work First (G.S. 143-15.3C). For the fiscal year 1997-98, the General Assembly established the Work First Reserve Fund. At the end of each fiscal year, the State Controller shall reserve State funds in an amount equalling one-fourth of any Work First Program funds from General Fund appropriations remaining unexpended at the end of the fiscal year, up to a maximum balance in the account of \$50 million. The General Assembly may appropriate additional funds into this reserve. The balance in this reserve at June 30, 1998 was \$19.5 million.

The following schedule summarizes current year changes in the budgetary reserve accounts. Amounts are expressed in thousands.

General Fund Reserved Fund Balance	Balance June 30, 1997	Increases			(Decreases)			Balance June 30, 1998
		Transfers from General Fund Unreserved Fund Balance	Appropriated Expenditure to General Fund Reserved Fund Balance	Unbudgeted Revenues	Transfers to General Fund Unreserved Fund Balance	Transfers to Non- General Fund Budgetary Funds	Unbudgeted Expenditures	
Savings.....	\$ 500,952	\$ 21,569	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 522,521
Retirees' health premium.....	190,640	—	—	171,936	—	—	(130,894)	231,682
Repairs and renovations.....	221,274	145,000	—	—	(174,261)	(17,823)	—	174,190
NC Railroad acquisition.....	61,000	—	—	—	—	—	—	61,000
Intangibles tax refunds.....	156,000	—	—	—	—	(156,000)	—	—
Clean water management.....	49,355	47,398	—	—	—	(49,355)	—	47,398
DPI allocation.....	—	55,028	—	—	—	—	—	55,028
Disproportionate share.....	—	—	—	35,447	—	—	—	35,447
Work First.....	—	—	19,541	—	—	—	—	19,541
Library grant.....	284	—	—	—	(284)	—	—	—
Chemical alcohol testing.....	353	—	—	—	—	(353)	—	—
Total.....	<u>\$ 1,179,858</u>	<u>\$ 268,995</u>	<u>\$ 19,541</u>	<u>\$ 207,383</u>	<u>\$ (174,545)</u>	<u>\$ (223,531)</u>	<u>\$ (130,894)</u>	<u>\$ 1,146,807</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 3: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Retained Earnings / Fund Balance Deficit

At June 30, 1998, the North Carolina Low Level Radioactive Waste Management Authority (component unit proprietary fund) had a \$49.564 million retained earnings deficit. The financial statements of the Authority have been prepared following the accounting principles which apply to developmental stage enterprises. The retained earnings deficit reflects losses sustained in the developmental stage, with recovery of these to occur from future operating revenues. Funds to finance developmental stage costs of the Authority have been advanced from the General Fund and will be repaid in the future if the Authority becomes operational.

At June 30, 1998, the following enterprise funds reported retained earnings deficits: Agricultural Farmers Market, \$3.20 million; Indian Cultural Tourist Center, \$92 thousand; and Workers' Compensation, \$3.024 million.

At June 30, 1998, the following internal service funds reported retained earnings deficits: Cherry Hospital Auxiliary Services, \$1.858 million, John Umstead Hospital Auxiliary Services, \$2.025 million and the Disability Income Plan of N.C., \$46.695 million.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4: DEPOSITS AND INVESTMENTS

A. Deposits and Investments with State Treasurer

Unless specifically exempt, every agency of the State and certain component units are required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Certain local governmental units that are not part of the reporting entity are also allowed to deposit money with the State Treasurer. Expenditures for the primary government and certain component units are made by warrants issued by the agencies and drawn on the State Treasurer. The State Treasurer processes these warrants each day when presented by the Federal Reserve Bank or the local clearing banks. General Statute 147-69.1 authorizes the State Treasurer to invest all deposits in obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; shares, deposits, savings certificates, and certificates of deposit of specified institutions; prime quality commercial paper; specified bills of exchange or time drafts; asset-backed securities; and corporate bonds and notes with specified ratings.

General Statute 147-69.2 authorizes the State Treasurer to invest the deposits of certain special funds, including the pension trust funds, the State Health Plan, the Disability Income Plan of N.C., the Escheats Fund, the Public School Insurance Fund, the State Education Assistance Authority, and trust funds of the University of North Carolina system, in the investments authorized in General Statute 147-69.1; general obligations of other states; general obligations of North Carolina local governments; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation. The deposits of the pension trust funds may be invested in all of the above plus certain insurance contracts; individual and group trusts; certain real estate investment funds; and certain stocks and mutual funds.

External Investment Pool

To ensure that these and other legal and regulatory limitations are met, all cash deposited with the State Treasurer, except for bond proceeds, are maintained in the Investment Pool. This pool, a governmental external investment pool, consists of the following individual investment portfolios:

Short-term Investment – This portfolio may hold any of the investments authorized by General Statute 147-69.1.

The Short-term Investment portfolio is the primary cash management account for the State and is managed in such a manner as to be readily convertible into cash. The primary participants of this portfolio are the General Fund and the Highway Funds. Other participants include the remaining funds listed below and various boards, commissions, community colleges, and school administrative units that make voluntary deposits with the State Treasurer.

Liquid Asset – This portfolio may hold the same investments as the Short-term Investment portfolio and is maintained for certain local governmental entities legally authorized to deposit moneys with the State Treasurer and certain deposits of the Employment Security Commission. The local government entities include public authorities, local governments, and ABC Boards that make voluntary deposits with the State Treasurer.

Long-term Investment – This portfolio may hold the fixed-income investments authorized by General Statutes 147-69.1 and 147-69.2. Since the deposits in this fund are typically not needed for day-to-day operations, the investment vehicles used generally have a longer term and higher return than those held in the Short-term Investment portfolio. The primary participants of the portfolio are the Pension Trust Funds and various special trust funds.

Equity Investment – This portfolio holds equities and equity-based mutual funds and trusts. The State's pension trust funds are the sole participants in the portfolio.

Real Estate Investment – This portfolio holds investments in real estate-based trust funds and group annuity contracts. The State's pension trust funds are the sole participants in the portfolio.

Venture Capital Investment – This portfolio holds investments in venture capital limited partnerships and the obligations or securities of the North Carolina Enterprise Corporation. The State's pension trust funds are the sole participants in the portfolio.

All of the above investment portfolios operate like individual investment pools, except that an investment portfolio may hold shares in other investment portfolios at the discretion of the State Treasurer and subject to the legal limitations discussed above. To this extent, the deposits are commingled; and therefore, the State Treasurer considers all

NOTES TO THE FINANCIAL STATEMENTS**NOTE 4: DEPOSITS AND INVESTMENTS (continued)**

investment portfolios to be part of a single pool, the Investment Pool. The Investment Pool contains deposits from funds and component units of the reporting entity (internal portion) as well as deposits from certain legally separate organizations outside the reporting entity (external portion). This pool is not registered with the SEC and is not subject to any formal oversight other than that of the legislative body.

At year end, the financial statements for the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

**Statement of Net Assets
June 30, 1998**

Assets:

Cash in bank.....	\$ 109,558
Accrued investment income.....	503,710
Investments.....	67,608,716
Total assets.....	<u>68,221,984</u>

Liabilities:

Undistributed income.....	42,120
Obligations under securities lending.....	9,323,352
Total liabilities.....	<u>9,365,472</u>

Net Assets:

Internal:	
Primary government.....	56,794,258
Component units.....	1,755,644
External.....	306,610
Total net assets.....	<u>\$ 58,856,512</u>

**Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 1998**

Increase in net assets from operations:**Revenues:**

Investment income.....	\$ 9,101,619
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Expenses:

Securities lending rebates and custodian fees.....	424,476
Investment management.....	44,386
Total expenses.....	468,862
Net increase in net assets resulting from operations.....	8,632,757

Distributions to participants:

Distributions paid and payable.....	(8,632,757)
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Share transactions:

Reinvestment of distributions.....	8,629,425
Net share purchases.....	56,272
Total increase in net assets.....	<u>8,685,697</u>

Net assets:

Beginning of year.....	50,170,815
End of year.....	<u>\$ 58,856,512</u>

The external portion of the Investment Pool is presented in the State's financial statements as an investment trust fund. Each fund and component unit's share of the internal equity in the Investment Pool is reported in the State's financial statements as an asset of those funds or

component units. Equity in the Short-term Investment portfolio and the Liquid Asset portfolio is reported as cash and cash equivalents while equity in the Long-term Investment, Equity Investment, Real Estate Investment, and Venture Capital Investment portfolios is reported as investments. The internal equity of the investment pool differs from the amount of assets reported by the funds and component units due to the typical banker/customer outstanding and in-transit items. Additionally, each fund or component unit's share of the assets and liabilities arising from securities lending transactions are reported in the funds and component units.

Investments in nonparticipating contracts, such as nonnegotiable certificates of deposit, are reported at cost. Other investments held in the Short-term Investment and Liquid Asset portfolios are reported at amortized cost, which approximates fair value. All other investments are reported at fair value. Fair values are determined monthly for the Long-term Investment and Equity Investment portfolios and quarterly for the Real Estate Investment and Venture Capital portfolios. The fair value of fixed income securities is based on future principal and interest payments discounted using current yields for similar instruments. Investments in real estate funds, venture capital limited partnerships, and equity investment funds are valued using market prices provided by the investment managers. Participants' shares sold and redeemed are determined in the same manner as is used to report investments, and the State Treasurer does not provide or obtain legally binding guarantees to support share values.

Net investment income earned by the Investment Pool is generally distributed on a pro rata basis. However, in accordance with legal requirements, the general fund receives all investment income earned by funds created for purposes of meeting appropriations. For the fiscal year ended June 30, 1998, \$86,185,022 of investment income associated with other funds was distributed to the general fund.

Bond Proceeds Investment Accounts

The State Treasurer has established separate investment accounts for each State bond issue to comply with IRS regulations on bond arbitrage. A private investment company under contract with the State Treasurer manages these separate accounts. The investments are valued at amortized cost, which approximates fair value. In the financial statements, each fund's equity in these accounts is reported as cash and cash equivalents.

Demand and Time Deposits

NOTES TO THE FINANCIAL STATEMENTS

Agency deposits to the investment pool may be made in any bank, savings and loan association or trust company in the State approved by the State Treasurer. Depositories are required, in accordance with the rules in the North Carolina Administrative Code (Chapter 20 NCAC 7), to collateralize all balances of the State Treasurer which are not insured. Basically, these rules require that the bank maintain, as collateral in an escrow account established by the State Treasurer with a third-party bank, securities of a type enumerated in the rules, in an amount whose market value is not less than the amount of the time deposits and the average balance of demand deposits for the preceding quarter less the allowable deposit insurance on the deposits. Generally, rules require the securities to be governmental in origin (e.g., U.S. Treasury and U.S. agency obligations, or state and local government obligations) or the highest grade commercial paper and bankers' acceptances. Financial institutions generally may elect to collateralize deposits separately (dedicated method) or to include the deposits of North Carolina local government units in the same collateral pool with the State and certain component units (pooling method). Financial institutions report quarterly on bank balances and amounts deposited in escrow as collateralization of deposits. The State Treasurer maintains no records of financial institution balances of local governments collateralized in the pool with State Treasurer deposits. Since the amounts of local government deposits in the pooling method banks are not known, the risk of being under-collateralized at any given time is increased. Therefore, the institution's financial condition may cause the State Treasurer to require a particular institution to utilize the dedicated method exclusively for the protection of each public depositor.

At June 30, 1998, the deposits maintained by the State Treasurer consisted of (dollars in thousands):

	<u>Carrying Value</u>	<u>Bank Balance</u>
Demand.....	\$ 109,558	\$ 106,098
Time.....	379,396	379,396
Total.....	<u>\$ 488,954</u>	<u>\$ 485,494</u>

At year end, 94.5 percent of the balances in financial institutions were deposited under the pooling method. Because the financial institutions complied with the collateralization policies and procedures by utilizing either the dedicated method or the pooling method described above, the State Treasurer considers all of its deposits to be either insured or covered by collateral held by the escrow agent.

Investments

Investments held by the investment pool and the bond proceeds investment accounts are categorized into three categories of credit risk to give an indication of the level of credit risk assumed by the entity at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the owner or its agent in the owner's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the financial institution's trust department or agent in the owner's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a financial institution's trust department or agent, but not in the owner's name. At year end, the balances of the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4: DEPOSITS AND INVESTMENTS (continued)

Investment Pool	Category		Carrying Amount
	1	3	
Investments Categorized:			
U.S. government and agency securities:			
Not on loan.....	\$ 12,928,294	\$ 46,844	\$ 12,975,138
On loan for securities collateral.....	520,172	—	520,172
Corporate bonds and notes:			
Not on loan.....	9,471,470	4,629,272	14,100,742
On loan for securities collateral.....	19,579	—	19,579
Repurchase agreements.....	70,000	4,512,070	4,582,070
Commercial paper.....	—	135,167	135,167
International bonds.....	514,478	—	514,478
Domestic equities.....	1,182	—	1,182
Total Investments Categorized.....	<u>\$ 23,525,175</u>	<u>\$ 9,323,353</u>	<u>32,848,528</u>
Investments Not Categorized:			
Certificates of deposit.....			379,396
Equity-based common trusts.....			24,675,075
Venture capital investments.....			36,452
Real estate trust funds.....			528,829
Investments held by broker/dealers under securities loans with cash collateral:			
U.S. government and agency securities..			8,906,240
Corporate bonds and notes.....			234,196
Total Investment Pool.....			<u>\$ 67,608,716</u>

The above certificates of deposit are a component of the deposit totals reported in the State Treasurer's demand and time deposit section of this note. At year end, the major investment classifications of the Investment Pool had the following attributes (dollars in thousands):

<i>Investment Classification</i>	<i>Carrying Amount</i>	<i>Principal Amount</i>	<i>Range of Interest Rates</i>	<i>Range of Maturities</i>
U.S. government and agency securities:				
U.S. Treasury notes and bonds.....	\$16,517,355	\$15,163,586	5.0 to 9.125%	1 day to 29 years
GNMA securities.....	4,432,460	4,326,337	6.5 to 9.0%	19 years to 30 years
FNMA and FHLMC securities.....	1,451,735	1,454,000	zero to 8.37%	1 day to 26 years
Corporate bonds and notes.....	14,354,517	13,844,241	5.625% to 14.5%	15 days to 37 years
Repurchase agreements.....	4,582,070	4,582,070	5.56% to 6.58%	1 to 6 days
Equity-based common trusts.....	24,675,075	Not applicable	Not applicable	Not applicable

The equity-based common trusts are investments in trust funds managed by third party money managers. The trust funds invest in common stocks and other equity-type securities. For these investments, the State Treasurer does not own individual securities but rather has a percentage ownership in the trust.

The U.S. government and agency securities include mortgage-backed securities issued by an agency of the United States government, the Government National Mortgage Association (GNMA) and government sponsored enterprises such as Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). The State Treasurer invests in these securities to maximize yield while maintaining a high degree of safety. The securities are based on cash flows from payments on underlying mortgages. Therefore, the investment values are sensitive to mortgage prepayments that tend to occur during periods of declining interest rates. In addition, certain portfolios within the Investment Pool utilize third party professional managers that have the authority to invest in collateralized mortgage obligations, financial futures, forwards, option swings, and other derivative instruments.

At year end, the balances of the bond proceeds investments were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

<i>Bond Proceeds</i>	<i>Category</i>	<i>Carrying</i>
<i>Investments Categorized:</i>	<i>1</i>	<i>Amount</i>
U.S. government and agency securities.....	\$ 1,900	\$ 1,900
Repurchase agreements.....	685,916	685,916
Commercial paper.....	179,608	179,608
Total Investments.....	<u>\$ 867,424</u>	<u>\$ 867,424</u>

Securities Lending

Based on the authority provided in G.S. 147-69.3(e), the State Treasurer lends securities from its investment pool to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. During the year the custodian lent U.S. government securities, corporate bonds and notes for collateral. The custodian is permitted to receive cash, U.S. government securities, or irrevocable letters of credit as collateral for the securities lent. The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower. Securities lent at year-end for cash collateral are presented as unclassified in the preceding schedule of custodial credit risk; securities lent for securities collateral are classified according to the category for the collateral. The State Treasurer cannot pledge or sell the collateral securities received unless the borrower defaults.

The cash collateral received is invested by the custodian agent and held in a separate account in the name of the State Treasurer. The average maturities of the cash collateral investments do not differ materially from the average maturities of the securities lent. While cash can be invested in securities ranging from overnight to two years, the custodian agent is not permitted to make investments where the weighted average maturity of all investments exceeds 90 days. At June 30, 1998, the weighted average maturity of unmatched investments was approximately two weeks.

At year-end, the State Treasurer has no credit risk exposure to borrowers because the amounts the Treasurer owes the borrowers exceed the amounts the borrowers owe the State. The securities custodian is contractually obligated to indemnify the Treasurer for certain conditions, the two most important are default on the part of the borrowers and failure to maintain the daily mark-to-market on the loans.

B. Deposits Outside the State Treasurer

In addition to the pooled deposits maintained by the State Treasurer, other deposits are maintained outside the State Treasurer by the primary government and by certain component units. As a general rule, these deposits are not covered by the rules in Chapter 20 NCAC 7 requiring collateralization of uninsured deposits.

At June 30, 1998, the deposits maintained outside the State Treasurer by the primary government consisted of (dollars in thousands):

	<i><u>Carrying Value</u></i>	<i><u>Bank Balance</u></i>
Demand.....	\$ 13,328	\$ 17,268
Time.....	698,867	712,375
Total Deposits.....	<u>\$ 712,195</u>	<u>\$ 729,643</u>

Of these bank balances, \$313.306 million was covered by federal depository insurance, \$375.566 million by collateral held by the escrow agent in the depositor's name, and \$40.771 million was uninsured and uncollateralized. In addition, the North Carolina Employment Security Commission had \$1.286 billion on deposit with the U.S. Treasurer at June 30, 1998.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 4: DEPOSITS AND INVESTMENTS (continued)**

At June 30, 1998, the deposits maintained by the component units consisted of (dollars in thousands):

	<u>Carrying Value</u>	<u>Bank Balance</u>
Demand.....	\$ 14,600	\$ 19,634
Time.....	82,900	93,894
Total Deposits.....	<u>\$ 97,500</u>	<u>\$ 113,528</u>

Of these bank balances, \$15.443 million was covered by federal depository insurance, \$25.656 million by collateral held by the escrow agent in the depositor's name, \$27.647 million was covered under the State Treasurer's collateral pool, \$3.606 million was covered by collateral held in the pledging bank's trust department in the depositor's name and \$41.176 million was uninsured and uncollateralized.

C. Investments Outside the State Treasurer

Investments in participating investment contracts, external investment pools, open-end mutual funds, debt securities, equity securities, and all investments of the Deferred Compensation Plan are reported at fair value. Investments in certificates of deposit, investment agreements, bank investment contracts, real estate, real estate investment trusts, and limited partnerships are reported at cost. Detailed disclosures about investments held outside the State Treasurer are presented below.

Primary Government

All organizations within the primary government are required to follow certain investment guidelines as outlined by the General Statutes. Of these organizations, the various clerks of superior court, the N.C. Deferred Compensation Plan (457), and the 401(k) Supplemental Retirement Income Plan comprise 98% of the total investments maintained by primary government at June 30, 1998. The investments by

these funds adhere to the following General Statutes guidelines.

General Statute 7A-112(a) authorizes the Clerk of the Superior Court to invest in the following: (a) Obligations of or fully guaranteed by the United States as to both principal and interest; (b) Obligations of the State of North Carolina; (c) General obligations of cities, counties, and special districts in North Carolina; (d) Shares of or deposits in specified savings and loan associations; (e) Savings certificates issued by specified savings and loan associations; (f) Certificates of deposit issued by specified banks.

General Statute 143B-426.25(j) allows the Deferred Compensation Plan Board to acquire investment vehicles from any company authorized to conduct such business in this State or may establish, alter, amend and modify, to the extent it deems necessary or desirable, a trust for the purpose of facilitating the administration, investment and maintenance of assets acquired by the investment of deferred funds. Any assets of such investment vehicles or trusts shall remain solely the property and rights of the State subject only to the claims of the State's general creditors.

General Statute 135-90 places no specific investment restrictions on the 401(k) Supplemental Retirement Income Plan. However, in the absence of specific legislation, the form of governance over the investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care.

At year end the investment balances maintained outside the State Treasurer for the primary government were as follows (dollars in thousands):

	<u>Category</u>			<u>Carrying Amount</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
Investments Categorized:				
U.S. Government securities.....	\$ 6,458	\$ 556	\$ 441	\$ 7,455
State and municipal securities.....	646	—	—	646
Corporate bonds.....	—	—	20	20
Corporate common stock.....	43	—	622	665
Repurchase agreements.....	—	—	2,100	2,100
Total Investments Categorized.....	<u>\$ 7,147</u>	<u>\$ 556</u>	<u>\$ 3,183</u>	<u>10,886</u>
Investments Not Categorized:				
Certificates of deposits.....				77,519
Bank investment contracts.....				301,182
Money market funds.....				4,660
Mutual funds.....				1,196,267
Annuity contracts.....				231,241
Total Investments.....				<u>\$ 1,821,755</u>

NOTES TO THE FINANCIAL STATEMENTS

The above certificates of deposit and bank investment contracts are a component of the deposit totals reported in the Deposits Outside the State Treasurer section of this note.

Component Units

The component units of the State (except for the North Carolina Railroad) are required to follow certain investment guidelines as outlined by the General Statutes. The component units include the University of North Carolina system, the community colleges and proprietary component units, such as the North Carolina Biotechnology Center, the North Carolina State Ports Authority, the Rural Economic Development Center, the Centennial Authority, and the North Carolina Housing Finance Agency. The investments by these units comprise 98% of the total investments maintained by the component units at June 30, 1998. The investments by the component units adhere to the following General Statutes guidelines.

General Statute 115D-58.6 authorizes the community colleges to invest in the following: (a) Obligations of or fully guaranteed by the United States; (b) Obligations of the State of North Carolina; (c) Bonds and notes of any North Carolina local government or public authority; (d) Obligations of certain non-guaranteed federal agencies; (e) Prime quality commercial paper bearing specified ratings and bankers' acceptances; (f) The North Carolina Cash Management Trust, an SEC registered mutual fund; (g) Commingled investment pool established and administered by the State Treasurer; (h) Repurchase agreements; (i) Evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity. General Statute 159-30 authorizes the Centennial Authority to invest in these same types of investments.

General Statute 122A-11 authorizes the North Carolina Housing Finance Agency to invest in the following: (a) Shares of or deposits in banks or trust companies outside as well as in this State, provided any such moneys on deposit outside this State are collateralized to the same extent and

manner as if deposited in this State; (b) Evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity of custodian; (c) Obligations which are collateralized by mortgage pass-through securities guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; (d) Trust certificate or similar instrument evidencing an equity investment in a trust or similar arrangement, which is formed for the purpose of issuing obligations which are collateralized by mortgage pass-through or participation certificates guaranteed by the Government National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Federal National Mortgage Association; (e) Repurchase agreements.

The General Statutes place no specific investment restrictions on the University of North Carolina system, the Rural Economic Development Center, the North Carolina Biotechnology Center, or the North Carolina State Ports Authority. However, in the absence of specific legislation, the form of governance over these investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. The University of North Carolina at Chapel Hill operates an Investment Fund, which is a governmental external investment pool. The University operates the Investment Fund for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Separate financial statements for the Investment Fund may be obtained from the University.

At year end, investment balances maintained outside the State Treasurer for the component units were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4: DEPOSITS AND INVESTMENTS (continued)

	Category			Carrying Amount
	1	2	3	
Investments Categorized:				
U.S. Government securities.....	\$ 122,591	\$ 69,895	\$ 15,379	\$ 207,865
Collateralized mortgage obligations.....	42,253	3,073	—	45,326
State and municipal securities.....	7,040	1,386	—	8,426
Corporate bonds.....	37,303	18,283	1,620	57,206
Corporate common stock.....	243,783	152,980	4,400	401,163
Repurchase agreements.....	165,596	—	7,364	172,960
Commercial paper.....	21,961	—	—	21,961
International corporate bonds.....	—	70	—	70
International government bonds.....	—	310	—	310
International equity securities.....	101,337	4,546	—	105,883
<i>Total Investments Categorized.....</i>	<u>\$ 741,864</u>	<u>\$ 250,543</u>	<u>\$ 28,763</u>	1,021,170
Investments Not Categorized:				
Certificates of deposits.....				26,055
Investment agreements.....				23,722
Bank investment contracts.....				3
Money market funds.....				126,879
Mutual funds.....				278,662
Real estate.....				39,765
Real estate investment trust.....				15,993
Limited partnerships.....				76,094
Investments held by broker-dealers under reverse repurchase agreements:				
U.S. Government securities.....				170,318
N.C. Cash Management Trust.....				675
Other investments.....				83,633
Total Investments.....				<u>\$ 1,862,969</u>

The above certificates of deposit, investment agreements and bank investment contracts are a component of the deposit totals reported in the Deposits Outside the State Treasurer (component units) section of this note.

Derivatives are not widely used by the various component units investing outside the State Treasurer. Of the above balances, only the Collateralized Mortgage Obligations (CMOs) and the limited partnership investments were considered material derivative positions during the year.

Collateralized Mortgage Obligations - The University of North Carolina at Chapel Hill and UNC Hospitals invest in collateralized mortgage obligations (CMOs) issued by FNMA, FHLMC and by certain trusts and private corporations. The CMOs represent a trust formed from a pool of mortgage loans issued by GNMA, FNMA, FHLMC, and the Mississippi Home Corporation. In a CMO, cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple classes with different priority claims and payment streams (commonly referred to as tranches.) A holder of the security thus chooses the class of security that best meets risk and return objectives. CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates, and various liquidity factors

related to their specific markets. The University and UNC Hospitals invest in these securities to increase the yield and return on their investment portfolios given the available alternative investment opportunities. At year-end, these CMOs had AAA ratings by Standard & Poor's and Moody's Investors Service.

Limited Partnerships - The limited partnership positions are held by the University system (University). The University uses various external money managers to identify specific investment funds and limited partnerships that meet asset allocation and investment management objectives. The University invests in these funds and partnerships to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain of these investments expose the University to significant amounts of market risk by trading or holding derivative securities and by leveraging the securities in the fund. The book value of these investments reflects their cost. The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes.

Reverse Repurchase Agreements - The University of North Carolina at Chapel Hill enters into fixed coupon

NOTES TO THE FINANCIAL STATEMENTS

reverse repurchase agreements, that is, the sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the university or provide securities or cash of equal value, the university would suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. This credit exposure at year-end was \$9.7 million. All sales under reverse repurchase agreements are for fixed terms. The university's policy for investing the proceeds of reverse repurchase agreements is that the term to maturity of the investment be the same as the term of the reverse repurchase agreement. Such matching existed at year-end.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 5: FIXED ASSETS

Primary Government:

A summary of changes in general fixed assets for the year ended June 30, 1998 is presented below (dollars in thousands).

	Balance July 1, 1997	Prior Year Adjustments	Transfers		Additions	Deletions	Balance June 30, 1998
			Between Assets	Between Funds			
Land.....	\$ 236,761	\$ 430	\$ (70)	\$ —	\$ 24,895	\$ 3,597	\$ 258,419
Buildings.....	1,354,835	(683)	22,305	93	10,269	317	1,386,502
Other structures and improvements.....	138,240	(1,293)	2,526	—	1,990	421	141,042
Machinery and equipment.....	877,553	1,128	24	53	132,951	43,664	968,045
Art, literature and artifacts.....	38,679	219	7	—	834	831	38,908
Construction in progress.....	283,529	(878)	(24,792)	—	127,774	—	385,633
Total — General Fixed Assets...	<u>\$ 2,929,597</u>	<u>\$ (1,077)</u>	<u>\$ —</u>	<u>\$ 146</u>	<u>\$ 298,713</u>	<u>\$ 48,830</u>	<u>\$ 3,178,549</u>

A summary of proprietary funds' fixed assets by classification for the primary government, at June 30, 1998, is presented below (dollars in thousands).

	Enterprise	Internal Service
Land.....	\$ 2,855	\$ 3,536
Buildings.....	25,569	36,446
Other structures and improvements...	7,068	12,223
Machinery and equipment.....	2,452	245,341
Construction in progress.....	774	5,038
	38,718	302,584
Less: Accumulated depreciation.....	(15,493)	(136,906)
Total Fixed Assets.....	<u>\$ 23,225</u>	<u>\$ 165,678</u>

Component Units:

A summary of fixed assets by classification for the component units, at June 30, 1998, is presented below (dollars in thousands).

Proprietary Funds					
	N.C. State Ports Authority	MCNC	N.C. Biotechnology Center	Other Component Units	Total
Land.....	\$ 12,561	\$ —	\$ —	\$ 3,220	\$ 15,781
Buildings.....	103,129	47,272	7,271	2,012	159,684
Other structures and improvements...	28,394	16,912	—	8,129	53,435
Machinery and equipment.....	47,354	—	1,591	5,287	54,232
Construction in progress.....	13,395	—	—	40,412	53,807
	204,833	64,184	8,862	59,060	336,939
Less:					
Accumulated depreciation.....	(87,858)	(54,250)	(2,894)	(3,563)	(148,565)
Total Fixed Assets.....	<u>\$ 116,975</u>	<u>\$ 9,934</u>	<u>\$ 5,968</u>	<u>\$ 55,497</u>	<u>\$ 188,374</u>

College and University Funds		
	University	Community Colleges
Land.....	\$ 64,766	\$ 51,889
Buildings.....	2,611,605	699,403
Other structures and improvements...	203,484	33,136
Machinery and equipment.....	645,837	115,372
Art, literature and artifacts.....	609,002	65,575
Construction in progress.....	502,563	170,158
	4,637,257	1,135,533
Total Fixed Assets.....	<u>\$ 4,637,257</u>	<u>\$ 1,135,533</u>

\$ 5,772,790

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6: LEASE OBLIGATIONS—OPERATING AND CAPITAL

The State and its component units have entered into various operating and capital leases for office space and for office, communications, computer and other equipment. Any operating leases with scheduled rent increases are considered immaterial to the future minimum lease payments and current rental expenditures. Operating lease payments are recorded as expenditures or expenses of the related funds when paid or incurred. For the year ended June 30, 1998, total operating

lease expenditures were \$30,782,498 for Primary Government, \$14,505,472 for Universities, \$2,338,994 for Community Colleges, and \$566,727 for other component units. Future minimum lease commitments for noncancelable operating leases and capital leases as of June 30, 1998 are (dollars in thousands):

Fiscal Year	Operating Leases		Capital Leases				
	<i>Primary Government</i>	<i>Component Units</i>	<i>Primary Government</i>	<i>Component Units</i>			
			General Long-Term Obligations	University Funds	Community Colleges Funds	Total Colleges and University Funds	<i>Proprietary MCNC</i>
1999.....	\$ 26,983	\$ 12,600	\$ 204	\$ 36	\$ 188	\$ 224	\$ 4,063
2000.....	20,199	8,781	—	26	182	208	—
2001.....	14,587	6,113	—	18	109	127	—
2002.....	9,887	3,058	—	—	8	8	—
2003.....	5,426	1,910	—	—	—	—	—
Thereafter.....	12,188	3,414	—	—	—	—	—
Total Future Minimum Lease Payments.....	\$ 89,270	\$ 35,876	204	80	487	567	4,063
Less Amounts Representing Interest			14	16	55	71	786
Present Value of Future Minimum Lease Payments			\$ 190	\$ 64	\$ 432	\$ 496	\$ 3,277

Falls Lake Operating Lease. The State has leased from the federal government approximately 40,000 acres of land and water areas at Falls Lake, located in Wake and Durham counties. The agreement allows the State to operate the areas for recreational purposes, and in return the State agreed to pay for one half of the development costs. Payments, which have not yet begun, are to take place over 50 years with an option to prepay. Current cost estimates indicate that the State has a total obligation of \$57.8 million, including \$31.4 million in interest and \$26.4 million in principal. Annual payments are estimated to be \$1.156 million beginning in fiscal 1998-99. Since the costs and payment period are yet to be finalized, this commitment has not been included in the above table.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7: LONG-TERM OBLIGATIONS

A. Changes in Long-Term Liabilities

During the year ended June 30, 1998, the following changes occurred in liabilities reported in the general long-term obligations account group (dollars in thousands):

	<i>Rates</i>	<i>Balance June 30, 1997</i>	<i>Accretion</i>	<i>Increases</i>	<i>Decreases</i>	<i>Balance June 30, 1998</i>
General Obligation Bonds :						
Public School Facility, Series C, 6-1-76.....	4.0-6.0	\$ 4,000	\$ —	\$ —	\$ 2,000	\$ 2,000
Clean Water, Series C, 6-1-76.....	4.0-6.0	2,000	—	—	1,000	1,000
Public Improvement, 11-1-78.....	4.8-5.0	3,000	—	—	3,000	—
Public Improvement, 1979, 11-1-79.....	5.5-7.5	10,000	—	—	5,000	5,000
Capital Improvement, Series 1989, 5-1-89.....	6.5-6.9	15,207	1,052	—	1,910	14,349
Capital Improvement, Series A, 3-1-91.....	5.75-6.0	41,400	—	—	8,300	33,100
Capital Improvement, Series 1991, 10-1-91.....	5.3-5.6	31,100	—	—	6,200	24,900
Prison and Youth Services Facilities, Series A, 3-1-92.....	5.9-6.2	41,900	—	—	6,700	35,200
Prison and Youth Services Facilities, Series B, 10-1-93.....	2.5-4.5	78,700	—	—	2,200	76,500
Public Improvement Refunding, Series 1993, 10-1-93.....	2.4-5.5	58,060	—	—	18,475	39,585
Clean Water Refunding, Series 1993, 10-1-93.....	3.0-5.0	14,860	—	—	4,235	10,625
Prison & Youth Services Facilities Refunding, Series C, 10-15-93.....	4.2-4.8	65,250	—	—	565	64,685
Capital Improvement Bonds, Series 1994A, 2-1-94.....	4.6-4.75	379,000	—	—	7,000	372,000
Clean Water, Series 1994A, 10-1-94.....	5.7-5.8	38,000	—	—	2,000	36,000
Clean Water, Series 1994B, 11-1-94.....	4.7-5.0	12,000	—	—	4,000	8,000
Clean Water, Series 1995A, 6-1-95.....	5.0-5.25	60,000	—	—	3,000	57,000
Clean Water, Series 1995B, 7/1/95.....	4.25-4.3	15,000	—	—	5,000	10,000
Capital Improvement Bonds, Series 1997, 1-1-97.....	4.8-5.1	195,000	—	—	3,000	192,000
Public School Building, Series 1997A, 3-1-97.....	5.1-5.2	450,000	—	—	8,000	442,000
Public School Building, Series 1998A, 4-1-98.....	4.75-5.0	—	—	450,000	—	450,000
Highway, Series 1997A, 11-1-97.....	4.5-5.0	—	—	250,000	—	250,000
Total Bonds Payable.....		<u>1,514,477</u>	<u>1,052</u>	<u>700,000</u>	<u>91,585</u>	<u>2,123,944</u>
Other Long-Term Obligations :						
Retiree tax judgements payable.....		—	—	399,000	—	399,000
Intangibles tax judgements payable.....		—	—	333,000	—	333,000
Claims payable.....		20	—	—	20	—
Notes payable.....	5.7	6,083	—	—	1,917	4,166
Deferred death benefit payable.....		100	—	—	—	100
Obligations for workers compensation.....		6,423	—	1,152	274	7,301
Capital leases payable.....		318	—	—	128	190
Accrued vacation leave.....		<u>165,820</u>	<u>—</u>	<u>29,355</u>	<u>3,783</u>	<u>191,392</u>
Total General Long-Term Obligations.....		<u>\$ 1,693,241</u>	<u>\$ 1,052</u>	<u>\$ 1,462,507</u>	<u>\$ 97,707</u>	<u>\$ 3,059,093</u>

B. Retiree and Intangibles Tax Judgements Payable

The North Carolina Supreme Court ruled in favor of the State retirees in the *Bailey* case on Friday, May 8, 1998. On June 9, 1998 representatives of the State and the various retirees involved in the *Bailey* and *Patton* (federal retirees) cases announced a settlement in the amount of \$799 million. Of this amount, a \$400 million expenditure and liability is reflected in the General Fund for refunds to be paid in fiscal year 1998-99, and a liability of \$399 million is reflected in the General Long-term Obligations Account Group for refunds to be paid during fiscal year 1999-2000.

The North Carolina Supreme Court ruled in favor of the taxpayers in the *Smith* and *Patton* cases on December 4, 1998. A timetable for payment has not been established. The total estimated liability of \$333 million is reported in the General Long-term Obligations Account Group.

NOTES TO THE FINANCIAL STATEMENTS

C. Bonds and Notes Payable

Bonds and notes payable at June 30, 1998 are (dollars in thousands):

	<u>Interest Rates</u>	<u>Final Maturity</u>	<u>Total</u>
Primary Government:			
General long-term obligations:			
Bonds payable.....	2.4 - 7.5	6/1/17	\$ 2,123,944
General long-term obligations:			
Notes payable.....	5.7	7/17/99	4,166
Enterprise Funds			
Notes payable.....	Variable	12/31/01	130
Component Units:			
University Funds:			
Bonds payable.....	2.88 - 9.05	2/14/29	838,993
Other Component Units:			
Housing Finance:			
Bonds payable...	3.7 - 8.25	1/1/30	957,696
Other:			
Bonds payable...	3.5 - 6.35	7/1/27	370,940
College and University Funds:			
Notes payable.....	0.00-7.4	5/1/22	43,520
Other Component Units:			
Notes payable.....	1.0 - 8.88	4/20/08	92,022

The full faith, credit, and taxing power of the State has been pledged only for the payment of the principal of and the interest on the general obligation serial bonds and capital appreciation bonds. Other long-term debts of the State and its component units are payable solely from certain resources of the funds to which they relate.

D. Bonds Authorized but Unissued

In November 1996, the voters of North Carolina approved bonds in the amount of \$1.8 billion for school construction and \$950 million for highway construction. On November 1, 1997, \$250 million of Highway Bonds, Series 1997A, with a settlement date of May 1, 2013, were sold. On April 1, 1998, \$450 million of Public School Building Bonds, Series 1998A, with a settlement date of April 1, 2016, were sold. The amount of authorized but unissued bonds was \$1.6 billion as of June 30, 1998.

The limitations on the increase of State debt are contained in the State Constitution, Article 5, Section 3. This section restricts the General Assembly from contracting debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State except for:

1. To fund or refund a valid existing debt;
2. To supply an unforeseen deficiency in the revenue;
3. To borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of such taxes;
4. To suppress riots or insurrections, or to repel invasions;

5. To meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor;
6. For any other lawful purposes, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium.

E. Capital Appreciation Bonds

General Obligation Bonds

Capital Improvement Bonds, Series 1989, 5-1-89, 5-24-89, include capital appreciation bonds recorded in the amount of \$14.349 million, which represents the accreted value of these bonds. The accumulated accretion for the capital appreciation bonds is \$9.93 million since May 24, 1989.

University Bonds

The *University of North Carolina at Chapel Hill, Series 1997 Utility System* and the *Series 1991 U. S. Environmental Protection Agency Project* bond issues include capital appreciation bonds with an ultimate maturity value of \$84,135,000 and \$25,275,000, respectively. These bonds are recorded in the amounts of \$31,486,000 and \$7,133,000, respectively, which is the accreted value at the year ended June 30, 1998. These bonds mature in the years from 2010 to 2021.

F. Demand Bonds

University Revenue Bonds

Parking System, Series 1997C

On June 19, 1997, the University of North Carolina at Chapel Hill issued variable rate demand bonds in the amount of \$10,750,000 that have a final maturity date of May 15, 2027. The bonds are subject to mandatory sinking fund redemption that begins on May 15, 2000. The proceeds of this issuance are to be used for the construction of the Health Affairs parking deck adjacent to UNC Hospitals on the campus of the University. The bonds are subject to purchase on demand with seven days notice and delivery to the University's paying agent, The Bank of New York. Smith Barney, Inc. is the remarketing agent.

The University has arranged for a standby bond purchase agreement with NationsBank, N. A., whereby the bank agrees to purchase 1997C bonds when remarketing proceeds are not available. This liquidity facility provides moneys only with respect to the purchase price of the bonds and does not otherwise secure payment of the bonds. The University is required to pay an annual commitment fee for the liquidity facility of .10% of the stated amount of the bonds then currently outstanding.

The University has agreed to pay interest on each liquidity bond at LIBOR (London Interbank Offering Rate)

NOTES TO THE FINANCIAL STATEMENTS**NOTE 7: LONG-TERM OBLIGATIONS (continued)**

plus .50% on each scheduled bond interest payment date. At June 30, 1998, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of the agreement is automatically extended for successive 364-day periods from the closing date, unless a notice of non-extension by NationsBank is received 365 days prior to the expiration date. As of June 30, 1998, the earliest such termination date is June 30, 1999.

Kenan Stadium, Series 1996

On November 7, 1996, the University of North Carolina at Chapel Hill issued variable rate demand bonds in the amount of \$13,800,000 that have a final maturity date of November 1, 2016. The bonds are subject to mandatory sinking fund redemption that begins on November 1, 1998. The proceeds of this issuance were used for certain additions and renovations to Kenan Memorial Stadium. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, NationsBank, N. A.

Under an irrevocable letter of credit issued by Wachovia Bank, N.A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on the bonds delivered for purchase. The University is required to pay an annual commitment fee for the letter of credit of .30% of the amount of bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed that upon the earlier of termination of the letter of credit or one year from a purchase draw date to repay amounts that represent purchase drawings under the letter of credit. Interest at the rate of prime is payable quarterly and upon draw repayment. At June 30, 1998, no purchase drawings had been made under the letter of credit.

The letter of credit automatically extends every month so that termination will not occur until 364 days after notice is received from Wachovia that the letter of credit will not be extended. As of June 30, 1998, the earliest such termination date is June 29, 1999.

Ambulatory Care Clinic, Series 1990

On May 15, 1990, the University of North Carolina at Chapel Hill issued money market municipal demand bonds in the amount of \$20,000,000 that have a final maturity date of July 1, 2012. The bonds are subject to mandatory sinking fund redemption that began on July 1, 1993. The proceeds of this issuance were used for financing the acquisition, construction,

and equipping of clinical facilities at the University's School of Medicine and for paying the issuance costs of the 1990 bonds. The bonds were converted from money market municipal bonds to weekly rate bonds effective May 31, 1995. The bonds are subject to purchase on demand with seven days notice and delivery to the University's paying agent, Bankers Trust Company. Lehman Brothers, Inc. is the remarketing agent.

The University has arranged a standby bond purchase agreement with NationsBank, N. A., whereby the bank will purchase bonds on a purchase date at the purchase price when remarketing proceeds or other funds are not available. This liquidity facility pays only the principal portion of the purchase price and does not secure payment of the principal of or interest on the bonds. The University is required to pay an annual commitment fee for the liquidity facility of .10% of the amount of bonds then currently outstanding.

The University has agreed to pay interest on each liquidity bond at LIBOR plus .40% on each scheduled bond interest payment date. At June 30, 1998, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of the agreement is automatically extended for successive 364-day periods from the closing date, unless a notice of non-extension by NationsBank is received 365 days prior to the expiration date. As of June 30, 1998, the earliest such termination date is June 30, 1999.

Ambulatory Care Clinic, Series 1992

On November 19, 1992, the University of North Carolina at Chapel Hill issued tax-exempt adjustable mode demand notes in the amount of \$3,000,000 that have a final maturity date of October 1, 2002. The bonds are subject to mandatory sinking fund redemption that began on October 1, 1994. The proceeds of this issuance were used to provide equipment for the ambulatory care building used by UNC Physicians and Associates and to pay the issuance costs of the notes. The notes are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Wachovia Bank, N. A.

The University has arranged a standby note purchase agreement with Wachovia Bank, N. A., whereby Wachovia will purchase notes tendered or deemed tendered for purchase on any purchase date at the purchase price plus accrued interest when remarketing proceeds or other funds are not available. The University is required to pay an annual commitment fee for the liquidity facility of .30% of the amount of notes then currently outstanding plus an amount for accrued interest.

NOTES TO THE FINANCIAL STATEMENTS

Notes held by Wachovia under this liquidity facility are subject to mandatory redemption 180 days after the date of purchase by Wachovia at an amount equal to the principal plus accrued interest at the Adjusted Euro-Dollar rate. At June 30, 1998, no notes had been purchased under the liquidity facility.

The liquidity facility terminates not earlier than 180 days following delivery of a termination notice by Wachovia. As of June 30, 1998, the earliest such termination date is December 27, 1998.

Carolina Inn, Series 1994

On September 27, 1994, the University of North Carolina at Chapel Hill issued taxable flexible term demand bonds in the amount of \$13,475,000 that have a final maturity date of November 15, 2019. The bonds are subject to mandatory sinking fund redemption that begins on November 15, 1998. The proceeds of this issuance were used to renovate and expand the Carolina Inn and to pay the costs incurred in connection with the issuance of the bonds. The bonds are subject to purchase on each interest payment date and on delivery to the University's paying agent, The Bank of New York.

The University has arranged a standby bond purchase agreement with NationsBank, N. A., whereby NationsBank will purchase bonds on a purchase date at the stated amount of principal plus accrued interest when remarketing proceeds or other funds are not available. The University is required to pay an annual standby fee for the liquidity facility of .10% of the amount of bonds then currently outstanding plus an amount for accrued interest.

The University has agreed to pay interest on each liquidity bond at LIBOR plus .50% on each scheduled bond interest payment date. At June 30, 1998, no bonds had been purchased under the liquidity facility.

The University is required to purchase or cause to be purchased any liquidity bonds purchased under the agreement upon expiration or termination of the agreement. The term of this agreement is automatically extended for successive 364-

day periods from the closing date, unless a notice of non-extension by NationsBank is received 365 days prior to the expiration date. As of June 30, 1998, the earliest such termination date is June 30, 1999.

School of Dentistry, Series 1995

On June 28, 1995, the University of North Carolina at Chapel Hill issued tax-exempt adjustable mode demand bonds in the amount of \$4,000,000 that have a final maturity date of September 1, 2010. The bonds are subject to mandatory sinking fund redemption that begins on September 1, 1999. The proceeds of this issuance are for the construction of a building called Tarrson Hall to house the majority of the School of Dentistry's patient care and clinical teaching facilities. The bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Wachovia Bank, N. A.

Under an irrevocable letter of credit issued by Wachovia Bank, N. A., the trustee is entitled to draw amounts sufficient to pay principal and interest on the bonds and amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase. The University is required to pay an annual commitment fee of .35% of the amount of the bonds then currently outstanding plus an amount for accrued interest.

The University has entered into a reimbursement agreement with Wachovia Bank in which it has agreed upon termination of the letter of credit to repay all amounts that are drawn under the letter of credit. Interest at the rate of prime for the first 90 days and prime plus 1.5% thereafter is payable quarterly and upon termination. At June 30, 1998, no drawings had been made under the letter of credit.

The letter of credit automatically extends every month so that termination will not occur until 13 months after notice is received from Wachovia that the letter of credit will not be extended. As of June 30, 1998, the earliest such termination date is July 5, 1999.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7: LONG-TERM OBLIGATIONS (continued)

G. Debt Service Requirements

Bonds Payable and Notes Payable

The following schedule shows the annual debt service requirements to pay principal and interest on general obligation bonds and revenue bonds, as well as on notes payable, outstanding at June 30, 1998 (dollars in thousands). Current and long-term principal requirements are disclosed for the enterprise and proprietary component unit funds.

Fiscal Year	Bonds Payable				Notes Payable			
	Primary Government	Component Units			Primary Government	Component Units		
	General	Proprietary			General			
	Long-Term Obligations	N. C.	Other	University	Long-Term Obligations			College and
	Account Group	Housing Finance	Proprietary Funds	Funds	Account Group	Enterprise Funds	Proprietary Funds	University Funds
1999	\$ 227,646	\$ 74,322	\$ 20,718	\$ 71,021	\$ 2,269	\$ 40	\$ 85,697	\$ 4,700
2000	221,490	77,206	20,781	72,497	2,257	40	1,350	29,470
2001	215,851	76,755	20,760	74,355	—	40	4,135	3,079
2002	209,821	76,490	23,803	74,263	—	10	778	2,126
2003	203,736	76,417	23,733	74,023	—	—	639	1,864
2004-2008	930,958	367,837	192,941	351,429	—	—	539	6,482
2009-2013	775,768	366,260	84,959	302,507	—	—	—	1,501
2014-2018	294,170	377,027	206,643	233,695	—	—	—	528
2019-2023	—	342,870	15,865	148,804	—	—	—	422
2024-2028	—	250,334	34,356	57,828	—	—	—	—
2029-2033	—	35,961	—	9,009	—	—	—	—
Total requirements	3,079,440	2,121,479	644,559	1,469,431	4,526	130	93,138	50,172
Less:								
Interest requirements	(948,825)	(1,144,513)	(273,619)	(616,302)	(360)	—	(1,116)	(6,310)
Unamortized discount	(6,671)	—	—	(13,404)	—	—	—	(342)
Deferred charges	—	(19,270)	—	(275)	—	—	—	—
Underwriters fees	—	—	—	(457)	—	—	—	—
Total principal requirements	<u>\$ 2,123,944</u>	<u>\$ 957,696</u>	<u>\$ 370,940</u>	<u>\$ 838,993</u>	<u>\$ 4,166</u>	<u>\$ 130</u>	<u>\$ 92,022</u>	<u>\$ 43,520</u>
Current portion		\$ 74,322	\$ 4,066			\$ 40	\$ 85,525	
Long-term portion		\$ 883,374	\$ 366,874			\$ 90	\$ 6,497	

NOTES TO THE FINANCIAL STATEMENTS**H. Arbitrage Rebate Payable**

The State and universities have incurred an arbitrage rebate liability in connection with general obligation and university revenue bonds sold in previous years. Arbitrage rebates payable at June 30, 1998, have been recorded (dollars in thousands) in the following funds:

Capital projects funds.....	\$ 33
University funds.....	<u>2,754</u>
Total	<u>\$ 2,787</u>

The State has fourteen general obligation bond issues currently outstanding that are subject to the arbitrage rebate provisions, thirteen of which may require future rebate payments. All bond proceeds and investment earnings for the \$75,000,000 Capital Improvement Bonds, Series A, have been expended. Therefore, no future rebate payments must be made for that bond.

I. Bond Defeasances**University of North Carolina at Chapel Hill**

On October 30, 1997, the University of North Carolina at Chapel Hill issued \$7,210,000 in *Housing System Revenue Refunding Bonds, Series 1997B* with an average interest rate of 4.61%. The refunding component of this bond issue was used to advance refund (defease) \$6,630,000 of outstanding *Housing System Revenue Bonds, Series 1991* with a combined average interest rate of 6.26%. Net proceeds of \$7,078,516 resulted from the bond sale. Of the net proceeds amount, \$7,076,396 was used to purchase U.S. government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by \$354,031 over the next 14 years and obtained an economic gain of \$254,541. At June 30, 1998, the outstanding balance was \$6,630,000 for the defeased *Housing System Revenue Bonds, Series 1991*.

On October 30, 1997, the University of North Carolina at Chapel Hill issued \$3,545,000 in *Student Fee Revenue Refunding Bonds, Series 1997* with an average interest rate of 4.67%. The refunding component of this bond issue was used to advance refund (defease) \$3,140,000 of outstanding *Student Fee Revenue Bonds, Series 1991* with a combined average interest rate of 6.86%. Net proceeds of \$3,492,744 resulted from the bond sale. Of the net proceeds amount, \$3,490,497 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not

included in the balance sheet. The University reduced its debt service requirements by \$250,369 over the next 14 years and obtained an economic gain of \$188,255. At June 30, 1998, the outstanding balance was \$3,140,000 for the defeased *Student Fee Revenue Bonds, Series 1991*.

On October 30, 1997, the University of North Carolina at Chapel Hill issued \$30,379,142 in *Utilities Systems Revenue Refunding Bonds, Series 1997* with an average interest rate of 5.42%. The refunding component of this bond issue was used to advance refund (defease) \$19,337,370 of outstanding *Utilities System Revenue Bonds, Series 1992* with a combined average interest rate of 6.74%. Net proceeds of \$30,025,663 resulted from the bond sale. Of the net proceeds amount, \$30,024,168 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by \$13,365,000 over the next 24 years and obtained an economic gain of \$4,824,859. At June 30, 1998, the outstanding balance was \$19,337,370 for the defeased *Utilities System Revenue Bonds, Series 1992*.

University of North Carolina at Asheville

On September 17, 1997, the University of North Carolina at Asheville issued \$7,600,000 in *Dormitory and Dining Hall System Revenue Bonds, Series C*, with a true interest cost of 5.17%. The refunding component of this bond issue was used to currently refund (defease) \$3,470,000 of outstanding *Dormitory and Dining Hall System Revenue Bonds, Series A*, with a combined average interest rate of 6.5%. Net proceeds of \$3,618,907 resulted from the bond sale. The University reduced its debt service requirements by \$511,765 over the next 15 years and obtained an economic gain of \$378,593.

Appalachian State University

On May 12, 1998, Appalachian State University issued \$27,535,000 in *Utility System Revenue Refunding Bonds, Series 1998* with an average interest rate of 5.29%. The refunding component of this bond issue was used to advance refund (defease) \$25,050,000 of outstanding *Utility System Revenue Bonds, Series 1994* with a combined interest rate of 6.21%. Net proceeds of \$26,820,994 resulted from the bond sale. Of the net proceeds amount, \$26,539,300 was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by \$1,565,283 over the next 26 years and

NOTES TO THE FINANCIAL STATEMENTS
NOTE 7: LONG-TERM OBLIGATIONS (continued)

obtained an economic gain of \$869,089. At June 30, 1998, the outstanding balance was \$25,050,000 for the defeased *Utility System Revenue Bonds, Series 1994*.

On May 12, 1998, Appalachian State University issued \$8,050,000 in *Student Fee Revenue Refunding Bonds (Student Union Building), Series 1998* with an average interest rate of 4.87%. The refunding component of this bond issue was used to advance refund (defease) \$7,570,000 of outstanding *Student Union Revenue Bonds, Series 1992 (Student Union Building)* with a combined average interest rate of 6.12%. Net proceeds of \$8,047,682 resulted from the bond sale. Of the net proceeds amount, \$7,982,300 was used to purchase U.S. Government Securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by \$221,067 over the next 14 years and obtained an economic gain of \$167,247. At June 30, 1998, the outstanding balance was \$7,570,000 for the defeased *Student Union Revenue Bonds, Series 1992*.

North Carolina Housing Finance Agency

On May 21, 1998, the North Carolina Housing Finance Agency issued \$11,805,000 in *Multifamily Revenue Bonds (1984 Resolution), Series J* with an average interest rate of 5.09%, the proceeds of which were used to optionally redeem the *Multifamily Revenue Bonds (1984 Resolution), Series E*. This refunding resulted in a deferred loss of approximately \$719,000, of which \$365,000 was unamortized bond issuance costs for the refunded issue. The refunding resulted in a

decrease in total debt service payments of \$6,616,000 and an economic gain of \$2,136,000. At June 30, 1998, the amount of outstanding defeased *Multifamily Revenue Bonds (1984 Resolution), Series E* was \$9,577,000.

Prior Year Defeasances

During prior years, the State and certain component units defeased certain general obligation and other bonds. For those defeasances involving advance refundings, the proceeds and any securities purchased with the proceeds were placed in an irrevocable trust with an escrow agent in an amount sufficient to provide for all future debt service payments on the refunded bonds. Since adequate funds have been placed with a trustee to pay fully the principal and interest on these bonds, the liabilities are not recorded in these financial statements. At June 30, 1998, the outstanding balance of current and prior year defeased bonds was \$59.6 million for the primary government and \$119.8 million for the component units.

J. Bond Redemptions

Provisions of bond series resolutions for the North Carolina Housing Finance Agency provide for various methods of redemption. Bonds are redeemed at par from prepayments of mortgage loans securing the issues or from unexpended bond proceeds of the issues along with the related decreases in the respective debt service reserve requirements. In addition, various bond issues are redeemable at the option of the Agency at premiums ranging up to 10% during periods from 10 to 16 years after the date of issuance.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 8: INTERFUND RECEIVABLES AND PAYABLES

Interfund receivables and payables as of June 30, 1998 are as follows (dollars in thousands):

	<u><i>Interfund Receivables</i></u>	<u><i>Interfund Payables</i></u>
Primary Government		
General:		
General Fund.....	\$ 126,278	\$ 28,217
Special Revenue:		
State Highway Fund.....	32,116	15,420
Highway Trust Fund.....	—	21,684
Employment Security Commission Funds.....	—	50
Employment and Training Administration Fund.....	—	11
Highway Patrol Fund.....	515	43
Community Colleges Special Programs Fund.....	—	46,140
Wildlife Resources Commission Fund.....	240	3,456
Other Funds.....	2,994	1,938
Total Special Revenue Funds.....	<u>35,865</u>	<u>88,742</u>
Capital Projects:		
Capital Projects Fund.....	3,250	291
Total Capital Projects Funds.....	<u>3,250</u>	<u>291</u>
Enterprise:		
Public School Insurance.....	—	1
N.C. State Fair.....	—	8
Total Enterprise Funds.....	<u>—</u>	<u>9</u>
Internal Service:		
State Health Plan.....	—	2
State Property Fire Insurance.....	—	396
Prison Enterprises.....	5,340	26
Motor Fleet Management.....	3,642	429
Courier Service.....	4	45
Temporary Solutions.....	27	1
N.C. Information Highway.....	6	79
Centralized Computing Services.....	7,614	1,251
State Telecommunications Services.....	7,365	97
Application Development Services.....	415	36
Decentralized Computing Services.....	409	—
Surplus Property.....	—	538
Total Internal Service.....	<u>24,822</u>	<u>2,900</u>

NOTES TO THE FINANCIAL STATEMENTS**NOTE 8: INTERFUND RECEIVABLES AND PAYABLES (continued)**

	<u><i>Interfund Receivables</i></u>	<u><i>Interfund Payables</i></u>
<i>Primary Government (continued)</i>		
<i>Expendable Trust:</i>		
Unemployment Compensation		
Funds.....	50	—
Escheat Fund.....	25,000	13,299
Recreation and Natural Heritage		
Trust Fund.....	187	—
Other Funds.....	474	26
Total Expendable Trust.....	<u>25,711</u>	<u>13,325</u>
<i>Pension Trust Funds:</i>		
Firemen's and Rescue Squad Workers'		
Pension Fund.....	<u>—</u>	<u>1</u>
<i>Agency:</i>		
Local Sales Tax Collections.....	4,254	—
Clerks of Court.....	321	1,878
Departmental.....	63	9,484
Total Agency.....	<u>4,638</u>	<u>11,362</u>
<i>Component Units</i>		
<i>Proprietary:</i>		
N.C. Housing Finance Agency.....	—	14
N.C. Global TransPark Authority.....	—	25,003
N.C. Low Level		
Radioactive Waste		
Management Authority.....	—	49,879
MCNC.....	195	—
State Education		
Assistance Authority.....	13,299	113
Rural Economic Development Center.....	—	1
Total Proprietary Funds.....	<u>13,494</u>	<u>75,010</u>
<i>College and University:</i>		
University Funds.....	72,992	68,958
Community Colleges Funds.....	<u>46,686</u>	<u>3,005</u>
Total University and		
Community College.....	<u>119,678</u>	<u>71,963</u>
Subtotal.....	<u>\$ 353,736</u>	<u>\$ 291,820</u>
Timing difference — N.C. Railroad Co....	<u>—</u>	<u>61,916</u>
Total.....	<u>\$ 353,736</u>	<u>\$ 353,736</u>

Included in the category of interfund receivables are "Due from other funds," "Due from component units," "Due from primary government," and "Advance to component units." Included in the category of interfund payables are "Due to other funds," "Due to component units," "Due to primary government," and "Advance from primary government." Interfund receivables exceeded interfund payables in the amount of the General Fund's \$61 million advance (plus accrued interest of \$916 thousand) to the North Carolina Railroad Company (Railroad), a discretely presented component unit. This difference is the result of different fiscal years of the State and the Railroad. The Railroad's financial statements are as of and for the fiscal year ended December 31, 1997.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 9: RETIREMENT PLANS**

The State administers six defined benefit public employee retirement plans which are included in the State's financial statements as pension trust funds. Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for payment of benefits to the members of that plan and for administrative costs, in accordance with the terms of the plan. Separate reports are not issued for the plans described below. The State also provides an optional retirement plan for certain university employees and a special separation allowance for eligible sworn law enforcement officers.

A. Plan Descriptions and Contribution Information**1. TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM**

This plan is a cost-sharing multiple-employer defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units. At June 30, 1998, the number of participating local boards of education and component unit employers was 196 as shown below:

Local boards of education.....	117
Community colleges	58
University of North Carolina system	17
Proprietary component units.....	4

Benefits and administrative expenses are funded by member contributions of 6% of compensation and by employer contributions of 7.78% of covered payroll for the period July 1, 1997 through June 30, 1998, in addition to investment income. Benefit and actuarially based contribution provisions are established by G.S. 135-5 and 135-8 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

2. CONSOLIDATED JUDICIAL RETIREMENT SYSTEM

This plan is a single-employer defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State Judicial System. Membership is comprised of judges, district attorneys and clerks of court. The plan provides retirement, disability and death benefits. Benefits and administrative expenses are funded by member contributions of 6% of compensation and employer contributions of 20.65% of covered payroll, for the period July 1, 1997 through June 30, 1998, in addition to investment income. Benefit and the actuarially based contribution provisions are established by G.S. 135-57, 135-58, 135-68 and 135-69 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

3. LEGISLATIVE RETIREMENT SYSTEM

This plan is a single-employer defined benefit plan established by the State of North Carolina to provide retirement and disability benefits for members of the General Assembly.

The benefit will not be payable while the member is employed in a position making him eligible to participate in either the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System or the Local Governmental Employees' Retirement System. The plan's benefits and administrative expenses are funded by member contributions of 7% of compensation and employer contributions of 22.58% of covered payroll for the period July 1, 1997 to June 30, 1998, in addition to investment income. Benefit and actuarially based contribution provisions are established by G.S. 120-4.21, 120-4.19 and 120-4.20 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 9: RETIREMENT PLANS (continued)***OTHER STATE ADMINISTERED SYSTEMS*

The State also administers the following pension and retirement plans for persons who are not considered employees of the State or its component units.

4. FIREMEN'S AND RESCUE SQUAD WORKERS' PENSION FUND

This plan is a defined benefit pension plan established by the State of North Carolina to provide pension benefits for all eligible firemen and rescue squad workers. Membership is composed of both volunteer and locally employed firemen and emergency medical personnel who elect membership. At June 30, 1998, there were 1,432 participating fire and rescue units. This is a special funding situation in that the State is not the employer but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by a \$10 monthly contribution by the member, investment income and an actuarially based state appropriation. Benefit and contribution provisions are established by G.S. 58-86 and may be amended only by the North Carolina General Assembly.

5. NATIONAL GUARD PENSION FUND

This plan is a defined benefit plan established by the State of North Carolina to provide pension benefits for members of the North Carolina national guard. This is also a special funding situation because the State is not the employer, but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by an actuarially based state appropriation and investment income. Benefit and contribution provisions are established by G.S. 127(a)-40 and may be amended only by the North Carolina General Assembly.

6. LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM

This plan is a cost-sharing multiple-employer defined benefit plan established by the State of North Carolina for employees of local governments. Membership is comprised of general employees and local law enforcement officers of participating local governmental entities.

At June 30, 1998, the number of participating local governments was 844, as shown below:

Cities	388
Counties	100
Special districts	356

The plan provides retirement benefits nearly identical to the benefits that accrue to members of the Teachers' and State Employees' Retirement System. This plan also provides disability benefits for members who become totally and permanently disabled from performing their usual job. Benefits and administrative expenses are funded by employee contributions of 6% and actuarially based employer contributions. Employers contribute 5.10% of covered payroll for law enforcement officers and 4.63% for general employees and firemen for normal costs and an unfunded liability rate, which is established when the government initially enters the system. The State's responsibility is administrative only. Benefit and contribution provisions are established by G.S. 128-27 and 128-30 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains.

The following table summarizes membership information by plan at the actuarial valuation date:

Employee Groups	<u>Teachers' and State Employees'</u>	<u>Judicial</u>	<u>Legislative</u>	<u>Firemen's, Rescue</u>	<u>National Guard</u>	<u>Local Governmental</u>
Retirees and beneficiaries currently receiving benefits	92,236	327	178	7,061	1,702	25,456
Terminated employees entitled to benefits but not yet receiving them	32,436	41	96	130	4,662	9,013
Active plan members	<u>271,128</u>	<u>456</u>	<u>167</u>	<u>25,928</u>	<u>7,659</u>	<u>106,802</u>
Total	<u>395,800</u>	<u>824</u>	<u>441</u>	<u>33,119</u>	<u>14,023</u>	<u>141,271</u>
Date of Valuation	12-31-97	12-31-97	12-31-97	6-30-97	12-31-97	12-31-97

NOTES TO THE FINANCIAL STATEMENTS**B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS*****BASIS OF ACCOUNTING***

The financial statements of these plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

INVESTMENTS

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains an investment pool in which the systems participate. The investment balance of each system represents its share of the fair value of the net assets of various portfolios within the pool. Additionally, the investment balance also includes assets occurring from securities lending transactions resulting from the systems' participation in the

pool. The investments of the State Treasurer are fully discussed in Note 4.

No retirement system has investments in any single commercial or industrial organization whose fair value would amount to more than five percent of the system's net assets available for benefits.

C. Actuarial Methods and Assumptions

The latest actuarial valuations are dated December 31, 1997, (June 30, 1997, for Firemen's and Rescue Squad Workers' Fund). The actuarial accrued liability and the schedule of funding progress are presented by system in the required supplementary section of this report. The actuarial value of assets for all systems is based on a five-year smoothed market value. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below are listed the various actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

<i>Retirement System</i>	<i>Valuation Date</i>	<i>Actuarial Cost Method</i>	<i>Amortization Method</i>	<i>Remaining Amortization Period</i>	<i>Period Open/Closed</i>	<i>Asset Valuation Method</i>	<i>Actuarial Assumptions</i>	
							<i>Investment Rate of Return</i>	<i>Projected Salary Increase</i>
Teachers' and State Employees'	12/31/97	Entry age	Level dollar	4 years	Open	5 year smoothed	7.25%	5.45-12.08%
Consolidated Judicial	12/31/97	Projected unit credit	Level percentage	40 years	Open	5 year smoothed	7.25%	5.63-12.58%
Legislative	12/31/97	Projected unit credit	Level dollar	None	Open	5 year smoothed	7.50%	7.50%
Firemen's, Rescue Squad Workers'	6/30/97	Entry age	Level dollar	4 years	Open	5 year smoothed	7.50%	N/A
National Guard	12/31/97	Entry age	Level dollar	7 years	Open	5 year smoothed	7.25%	N/A
Local Governmental Employees'	12/31/97	Frozen entry age	Level percentage	Various	Closed	5 year smoothed	7.25%	5.45-12.08%

N/A-Not applicable

NOTES TO THE FINANCIAL STATEMENTS**NOTE 9: RETIREMENT PLANS (continued)**

The valuation for the Local Governmental Employees' system includes a .01% increase in the retirement formula enacted by the General Assembly effective July 1, 1998. The valuations also reflect legislation that authorized a 2.5% cost of living increase (also effective July 1, 1998) for retirees in all systems with projected salary increases. The projected investment returns for all systems, except the Legislative and Firemen's, include a 3.75% inflationary factor within the actuarial assumption. For Firemen's, the inflationary factor is 4%. The assumption for the Legislative system does not identify an inflationary factor.

CURRENT FISCAL YEAR ASSUMPTIONS

The annual required contributions for the fiscal year ended June 30, 1998, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, and National Guard systems' valuations were as of December 31, 1995, the Legislative system was valued at December 31, 1996, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 1996. These prior actuarial valuations used actual cost to value investment assets and had remaining amortization

periods of 9 years for Teachers' and State Employees', 9 years for Consolidated Judicial, 9 years for National Guard and 6 years for the Firemen's and Rescue Squad Worker's Fund. Prior valuations of the Local Governmental Employees' system used the aggregate actuarial cost method and consequently had various amortization periods. The above-mentioned valuations assumed an investment return rate of 7.5% and projected salary increases significantly the same as the most current valuations.

Unless otherwise noted in this footnote or in the required supplementary schedules, the actuarial values, methods and significant assumptions for the current year's required contributions are the same as those presented in the table shown on the prior page. The Teachers' and State Employees', Local Governmental Employees', and Consolidated Judicial systems were amended effective July 1, 1997, to provide a 4.0% post-retirement benefit increase. Additional benefit enhancements increased the benefit accrual rate in the Teachers' and State Employees' system from 1.75% to 1.80% and in the Local Governmental Employees' system from 1.72% to 1.76%. The liabilities for these enhancements were reflected in the December 31, 1996, individual systems' valuations.

D. Annual Pension Cost and Net Pension Obligation

The annual pension costs and net pension obligations for the State's single-employer and special funding defined benefit plans for the current fiscal year are as follows:

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution.....	\$ 8,485,133	\$ 741,161	\$ 11,735,187	\$ 2,533,000
Interest on net pension obligation.....	—	(40,020)	—	—
Adjustment to annual required contribution.....	—	131,754	—	—
Annual pension cost.....	8,485,133	832,895	11,735,187	2,533,000
Contributions made.....	8,485,133	800,737	11,735,187	2,533,000
Increase (decrease) in net pension obligation.....		32,158		
Net pension (asset) obligation beginning of year....	—	(533,605)	—	—
Net pension (asset) obligation end of year.....	\$ —	\$ (501,447)	\$ —	\$ —

NOTES TO THE FINANCIAL STATEMENTS

The following table presents the required three year trend of pension costs for the State's single-employer and special funding defined benefit plans and the required contributions the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. The State's contribution equals its pension expense/expenditures for the System. The State does not make any contributions to the Local Governmental Employees' System; therefore, it does not have any related pension cost. The dollar amounts are expressed in thousands.

**State of North Carolina's Annual Pension Cost (APC)
and Annual Required Contributions (ARC) as an Employer**
For the Years Ended June 30, 1996 through June 30, 1998 (in thousands)

	<u>Teachers' and State Employees'</u>	<u>Judicial</u>	<u>Legislative</u>	<u>Firemen's, Rescue</u>	<u>National Guard</u>
Primary Government:					
1998	\$ 172,530	\$ 8,485	\$ 833	\$ 11,735	\$ 2,533
1997	170,342	7,976	840	11,735	2,303
1996	161,225	7,536	837	11,735	2,283
Component units:					
Universities:					
1998	\$ 79,572				
1997	79,168				
1996	75,883				
Community Colleges:					
1998	\$ 28,953				
1997	28,432				
1996	27,055				
Proprietary Funds:					
1998	\$ 1,038				
1997	1,141				
1996	1,087				
Total Primary Government and Component Units:					
1998	\$ 282,093	\$ 8,485	\$ 833	\$ 11,735	\$ 2,533
1997	279,083	7,976	840	11,735	2,303
1996	265,250	7,536	837	11,735	2,283
Percentage of APC Contributed:					
1998		100%	96%	100%	100%
1997		100%	95%	100%	100%
1996		100%	90%	100%	100%
Percentage of ARC Contributed:					
1998	100%				
1997	100%				
1996	100%				
Net Pension (Asset) Obligation:					
1998		\$ —	(501)	\$ —	\$ —
1997		—	(534)	—	—
1996		—	(572)	—	—

The pension liabilities for the transition year (1997) were determined in accordance with GASB 27. The prior year pension liability and current pension liability for all systems, except Legislative, are zero. Each year's APC and Net Pension Asset for the Legislative System were calculated in accordance with GASB 27 back to 1993 and contain the cumulative effect of applying this statement.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9: RETIREMENT PLANS (continued)**E. Optional Retirement Plan**

The Optional Retirement Program (Program) is a defined contribution retirement plan which provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and administrators with faculty rank in universities of the UNC system may join the Program instead of the Teachers' and State Employees' Retirement System. At June 30, 1998, the Plan had 7,359 participants.

Benefits are provided by means of contracts issued and administered by the privately-operated Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF), Valic, and Lincoln National Life Insurance Company. Participants' eligibility and contributory requirements are established in G.S. 135-5.1. Participants contribute 6% of compensation and the university contributes 6.84%. There is no liability other than the universities' required contributions. The universities contributed \$35,665,924 for the 1997-98 fiscal year. Annual covered payroll was \$521,431,644 and employer contributions expressed as a percentage of annual covered payroll was 6.84% for the fiscal year ended June 30, 1998. Employee contributions expressed as a percentage of annual covered payroll were 6%, with an actual employee contribution of \$31,285,898 for the 1997-98 fiscal year.

Participants are vested after five years of service, but the company must return the value of the universities' contributions to the State if termination occurs prior to five years of service. The participant chooses his/her own investment products with the company of choice.

F. Special Separation Allowance

The State provides a special separation allowance (SSA), an agent multiple-employer defined benefit pension plan, for sworn law enforcement officers as defined by G.S. 135-1(11b) or G.S. 143-166.30(a)(4) that were employed by State agencies and component units and have retired on a basic service retirement under the provisions of G.S. 135-5(a). To qualify for the allowance, each retired officer must: (1) have completed 30 or more years of creditable service or have attained 55 years of age and completed five or more years of creditable service; and (2) not have attained 62 years of age; and (3) have completed at least five years of continuous service as a law enforcement officer immediately preceding a service retirement. Each eligible officer is paid an annual separation allowance equal to .85% of the officer's most recent base rate of compensation for each year of creditable service. For the fiscal year ended June 30, 1998, the State and its component units paid \$6,430,510 for 587 retired law enforcement officers. These benefits are funded on a pay-as-you-go basis with each employer (the State or component unit) responsible for the benefits to their former employees. There is no statewide administration of the SSA and there is no actuarial valuation performed. Funds for this allowance are appropriated annually in the budget of each state agency or paid from the component unit's operations for those employers who have eligible, retired law enforcement officers. These benefits are established in G.S. 143-166.41 and may be amended only by the General Assembly.

NOTE 10: DEFERRED COMPENSATION PLANS

IRC Section 457 Plan - The State of North Carolina offers its permanent employees, university employees, and employees of certain other component units, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan permits each participating employee to defer a portion of his or her salary until future years by having the funds invested in various instruments that make up the North Carolina Public Employee Deferred Compensation Trust Fund. This fund is held for the exclusive benefit of employees of the State and their beneficiaries. The deferred compensation is available to employees upon separation from service, death, disability, and retirement or due to financial hardships if approved by the Board of Trustees of the plan. The plan is administered by a third party and is reported in the CAFR as an expendable trust fund. Prior to the 1997-98 fiscal year the plan was reported as an agency fund, but during the 1997-98 fiscal year, the State implemented GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans* which required this reclassification. All costs of administering and funding the plan are the responsibility of the plan participants.

IRC Section 401(k) Plan - Effective January 1, 1985, Chapter 135, Article 5 of the North Carolina General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina (the Plan) in accordance with Internal Revenue Code Section 401(k). All members of the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System, Legislative Retirement System, Local Governmental Employees' Retirement System and University Optional Retirement Program are eligible to enroll in this plan and may contribute up to 14% (limited to \$9,500 in 1997) of their compensation during the plan fiscal year. Members of the Plan may receive their benefits upon retirement, disability, termination, hardship, or death. All contributions and costs of administering the Plan are the responsibility of the participants.

The Plan is a defined contribution pension plan that is administered by a third party. The administrator prepares financial statements based on the plan fiscal year. The audited statements for the year ended December 31, 1997, are presented in this financial report as an expendable trust fund. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The Plan's financial statements are

NOTES TO THE FINANCIAL STATEMENTS

prepared using the accrual basis of accounting. Investments are reported at fair value. Securities and mutual funds are based on published quotations while bank investment contracts are stated at contract value. Participant loans are reported at outstanding principal balances. The plan is administered by the Branch Banking and Trust Company (BB&T) and the Plan's financial statements are available by contacting the N.C. 401(k) Plan, P.O. Box 29541, Raleigh, NC 27626.

In addition to the voluntary contribution criteria above, G.S. 143-166.30 requires state contributions to the Plan to provide benefits for all law enforcement officers employed by the State and its component units. G.S. 143-166.50 requires local governmental units with law enforcement officers to also contribute at least as much as the State. Participation begins at the date of employment. State agencies and component units are required to contribute monthly to the individual accounts of participants an amount equal to 5% of each officer's monthly salary. The State is also required to contribute to the individual accounts of all officers on a per capita basis in equal shares, \$.50 for each court cost assessed and collected under G.S. 7A-304 goes to state law enforcement officers, while \$1.25 of each assessment goes to local law enforcement officers. General Statutes allow law enforcement officers to voluntarily contribute up to 10% of their compensation within any calendar year, but current Internal Revenue Code restrictions limit the actual voluntary contribution to 9% of the officers' compensation. All contributions are immediately vested in the name of each participant. At December 31, 1997, 196 state agencies and component units along with 916 local governmental units were contributing to the Plan.

At December 31, 1997, the Plan disclosed the following investments (at fair value) exceeding five percent of the Plan net assets:

BB&T Money Rate Savings Accounts.....	\$ 139,280,000
BB&T Bank Investment Contracts.....	301,182,000
Fidelity Equity-Income Fund.....	242,654,000
Fidelity Magellan Fund.....	561,109,000
Fidelity Spartan U.S. Equity	91,287,000
Participant Loans	81,154,000

The Plan also reported total member contributions of \$101,892,000. The payrolls for law enforcement officers, on which the required contributions were based for the year ended December 31, 1997, amounted to \$112,069,544 for the State, \$10,545,180 for universities, and \$796,978 for the other miscellaneous component units. The required 5% employer's contribution was made by the State for \$5,603,477, by universities for \$527,259, and by the remaining component units for \$39,849. In addition, the State contributed \$517,592 for the required court cost assessments.

IRC Section 403(b) Plans - Employees of the UNC system and community colleges can participate in tax-sheltered annuity contracts and custodial accounts created under Internal Revenue Code (IRC) Section 403(b). Generally all employees are eligible, but the IRC does allow the establishment of a minimum contribution of \$200 and the exclusion from participation of certain classes of employees. Each institution may exclude one or more of these classes if every employee within the institution meeting the class criteria is excluded from participation. The employees' eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the accumulated balances are received or the contributions are withdrawn. Effective January 1, 1989, contributions may be withdrawn by employees only upon separation from service, death, disability, reaching age 59 1/2 or age 55 with qualifying retirement, or due to certain financial hardships. Currently, there is no restriction on the withdrawal of the value of annuity contracts. Custodial accounts established as of December 31, 1988 can be withdrawn only in respect to hardship established as of December 31, 1988. These plans are exclusively for employees of public educational organizations and certain charitable and other non-profit institutions as defined by the IRC. Since all contributions are made voluntarily by employees, all costs are borne by the plans' participants. No direct costs are incurred by the State.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11: OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees

The State Health Plan provides postemployment health insurance to former employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity. Those former employees who are eligible to receive health care as an other postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), the Legislative Retirement System (LRS), and the University Employees' Optional Retirement Program (UEORP), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. For the fiscal year ended June 30, 1998, the number of participants currently eligible to receive health care as an other postemployment benefit are 38,893 TSERS and DIPNC members (excluding LEA members), 220 CJRS members, 124 LRS members, and 380 UEORP members. The health insurance plan is the same as for active employees as described in Note 12, except that the coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in either the self-funded Comprehensive Major Medical Plan (Plan) or one of the health maintenance organization (HMO) plans.

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the Appropriation Bill by the General Assembly. The State, participating component units, and LEAs contributed a monthly amount equal to 2.0% of active employees' salaries to the General Fund's Reserve for Retirees' Health Premium Account (Reserve). The Reserve pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan and makes similar contributions for long-term disability beneficiaries and retirees enrolled in the HMO plans. Long-term disability beneficiaries and retirees pay for the additional cost of HMO coverage in excess of the Reserve's contribution and for the entire cost of coverage for their spouses and dependents. For the fiscal year ended June 30, 1998, the Reserve paid \$1,320.96 for each Medicare-eligible long-term disability beneficiary and retiree and \$1,735.20 for each non-Medicare-eligible long-term disability beneficiary and retiree. At June 30, 1998, the Reserve had net assets at fair value of \$253,499,702. The net assets are available for future

benefit payments. For the fiscal year ended June 30, 1998, contributions on behalf of former employees of the reporting entity were made to the Reserve as follows:

Primary government.....	\$45,244,840
University of North Carolina system.....	31,475,511
Community colleges.....	7,442,876
Certain participating proprietary component units.....	<u>266,966</u>
Total contributions.....	<u>\$84,430,193</u>

These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

B. Disability Income

As discussed in Note 12, short-term and long-term disability benefits are provided to the eligible members of the Teachers' and State Employees' Retirement System and the University Employees' Optional Retirement Program through the Disability Income Plan of North Carolina (DIPNC), an internal service fund. Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in the Teachers' and State Employees' Retirement System of North Carolina (Retirement System) or the University Employees' Optional Retirement Program, earned within ninety-six months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from the Retirement System; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from the Retirement System after (1) reaching the age of 65 and completing five years of creditable service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

NOTES TO THE FINANCIAL STATEMENTS

The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one twelfth of the annual longevity payment to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of \$3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than \$10 a month. When an employee qualifies for an unreduced service retirement allowance from the Retirement System, the benefits payable from DIPNC will cease, and the employee will commence retirement under the Teachers' and State Employees' Retirement System or the University Employees' Optional Retirement Program.

Long-term disability income benefits are advance-funded on an actuarially determined basis using the one-year term cost method. Disability income benefits are funded by employer contributions that are established in the Appropriations Bill by the General Assembly. For the calendar year ended December 31, 1997, the State, the University of North Carolina system, community colleges, and certain participating proprietary component units, and LEAs contributed .52% of active employees' salaries to fund the disability benefits. The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees.

At December 31, 1997, DIPNC had 2,608 members, excluding LEA members, who were currently eligible to receive disability benefits as an other postemployment benefit out of a total of 237,945 active plan participants. Those individuals who are receiving extended short-term disability benefit payments cannot be separated from the number of members currently eligible to receive disability benefits as an other postemployment benefit.

The basis for estimating the liabilities for unpaid claims is discussed in Note 12. The market related actuarial value of the assets of DIPNC at December 31, 1997, was \$163,296,023, creating a deficit of \$68,995,580. The fair value of the assets for DIPNC at December 31, 1997 was \$177,327,727. The assets are available for future other postemployment benefits and benefits for eligible active employees.

Actuarial Assumptions for the calendar year ended December 31, 1997:

Discount rate	7.25%
Rate of return on investments assumption	7.25%
Projected salary increase assumption	5.75%
Projected social security benefits increase assumption	3.75%
Social security assumption	75%
Actuarially required contribution	\$20,979,702
Actual contribution made by:	
Primary Government	\$11,220,533
University of North Carolina system	7,802,925
Community Colleges	1,882,326
Certain participating proprietary component units	73,918
Total actual contribution made	<u>\$20,979,702</u>

These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 12: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pools

1. Public School Insurance Fund

The Public School Insurance Fund (the Fund) is a public entity risk pool reported within the enterprise funds. In accordance with Chapter 115C, Article 38, of the General Statutes, the purpose of the Fund is to insure the Local Education Agencies (LEAs), which are not a part of the reporting entity. The community colleges, which are component units, can also acquire insurance through the Fund as stated in G.S. 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to carry extended coverage against fire and lightning damage to the extent of not less than seventy-five percent (75%) of the current insurable value for each insurable building. The boards also are to insure adequately the equipment and contents of said building. The Fund is financed by premiums collected from the LEAs and the community colleges and interest earned on the Fund's cash balance. Each board has to give notice of its election to insure in the Fund at least 30 days prior to such insurance becoming effective and shall furnish to the State Board of Education a full and complete list of all outstanding fire insurance policies. While the said insurance policies remain in effect, the Fund shall act as coinsurer of the properties covered by such insurance. The Fund currently insures 105 out of 117 LEAs and 21 out of 58 community colleges.

Claim liabilities are based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. For the current fiscal year, the Fund has amended the calculation of the incurred but not reported claims, and this change is reflected in the liability for unpaid claims at year end. There are no salvage claims anticipated since any salvage is adjusted in the claim settlement. There are no subrogation claims pending. Since claims are reviewed by adjusters and the actual loss projection is computed in a short time after the claim is reported, the claim adjustment expense associated with the unpaid claim liability will be reflected in the current period. The Fund does consider investment income in determining if a premium deficiency exists.

The only acquisition costs are related to proposal costs and inspection costs for new insurance. Since the Fund can only insure the LEAs and the community colleges, new contracts are immaterial. Since existing contracts are renewed once a year, the Fund's costs are for policy maintenance. Therefore, acquisition costs do not need to be amortized.

During the fiscal year ended June 30, 1997, the State suffered significant damage from two hurricanes, Bertha and Fran, which greatly increased the claims submitted to the Fund for that year.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year	
	1998	1997
Unpaid claims at beginning of year	\$ 4,904	\$ 1,436
Incurred claims:		
Provision for insured events		
of the current year	5,510	15,060
Increases (decreases) in provision		
for insured events of prior years	(644)	(192)
Total incurred claims	<u>4,866</u>	<u>14,868</u>
Payments:		
Claims attributable to insured		
events of the current year	2,044	9,595
Claims attributable to insured		
events of the prior years	<u>3,560</u>	<u>1,805</u>
Total payments	<u>5,604</u>	<u>11,400</u>
Total unpaid claims at end		
of the year	<u>\$ 4,166</u>	<u>\$ 4,904</u>

With the collection of premiums from the insured educational units, payment of valid claims becomes the responsibility of the Fund. All claims greater than \$10 million per occurrence (up to \$30 million per location) are covered by reinsurance policies. Total payments by the Fund over \$20 million a year (March 20, 1997 - March 20, 1998) are also paid by the reinsurers. Maximum recoverable from the reinsurers for any one catastrophe is \$1 billion per occurrence, or a \$300 million maximum on a flood or earthquake. Incurred losses are reduced by estimated amounts recoverable under the Fund's reinsurance policies. Currently there are claims recoverable from the reinsurers for an estimated \$700,000 due to Hurricane Fran.

NOTES TO THE FINANCIAL STATEMENTS**2. Workers' Compensation Fund**

The Workers' Compensation Fund (the Fund) is a public entity risk pool reported within the enterprise funds. The Fund is created in the Department of Insurance (the Department) and is administered by the State Fire and Rescue Commission (the Commission) through a service contract with a third-party administrator. In accordance with Chapter 58, Article 87, of the General Statutes, the purpose of the Fund is to provide workers' compensation benefits to members of "eligible units," which consist of volunteer fire departments or volunteer rescue/EMS units that are not part of a unit of local government and are exempt from State income tax under G.S. 105-130.11. These eligible units are not part of the reporting entity. Benefits are payable for compensable injuries or deaths which occurred on or after July 1, 1996. The Fund is financed by appropriations made to the Department for this purpose and by per capita fixed dollar amounts for each member of a participating eligible unit's roster. The per capita fixed dollar amount is set annually by the Commission and is paid by the eligible units to the Commission on or before July 1 of each year for credit to the Fund. If payment is not received by July 1, the eligible unit shall not receive workers' compensation coverage for that fiscal year. The appropriation for the fiscal year ended June 30, 1998 was \$4,500,000. As of June 30, 1998, the Fund consisted of 1,128 eligible units representing approximately 34,950 members.

The liability for unpaid claims is based on an actuarial determination and represents a reasonable estimate of the ultimate cost of open claims and claim settlement expenses that are unpaid as of the fiscal year end, including incurred but not reported losses. The liability for unpaid claims is continually reviewed, and as adjustments become necessary such adjustments are included in current operations. The Fund considers anticipated investment income in determining if a premium deficiency exists. The Fund recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 1998, there was no reduction for subrogation.

Acquisition costs consist of commission payments to independent insurance agents for marketing, promotional and administrative assistance with policy maintenance to eligible units. As coverage is renewed annually, acquisition costs are not amortized.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year	
	1998	1997
Unpaid claims at beginning of year	\$ 2,962	\$ —
Incurred claims:		
Provision for insured events		
of the current year	2,982	3,659
Increases (decreases) in provision		
for insured events of prior years	162	—
Total incurred claims	<u>3,144</u>	<u>3,659</u>
Payments:		
Claims attributable to insured		
events of the current year	485	697
Claims attributable to insured		
events of the prior years	763	—
Total payments	<u>1,248</u>	<u>697</u>
Total unpaid claims at end		
of the year	<u>\$ 4,858</u>	<u>\$ 2,962</u>

The Fund maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Fund's retention of \$500,000 per occurrence and a \$1,000,000 limit for employer's liability above the Fund's retention of \$500,000 per occurrence. The aggregate reinsurance provides for \$3,000,000 of coverage above aggregate Fund losses of \$5,012,375 for any one accident year. Incurred losses are reduced by estimated amounts recoverable under the Fund's excess of loss and aggregate reinsurance policies. As of June 30, 1998, there are claims recoverable from reinsurers in the amount of \$829,967.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 12: RISK MANAGEMENT AND INSURANCE (continued)****B. Employee Benefit Plans****1. State Health Plan**

In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State provides comprehensive major medical care for employees and retirees of the State and its participating component units, as well as their dependents. This care is also extended to employees and retirees of the Local Education Agencies (LEAs), which are not part of the State's reporting entity. Coverage is self-funded by contributions to the State Health Plan (the Plan), an internal service fund of the State. Contributions for employee and retiree coverage are made by the State, its participating component units, and LEAs. Contributions for dependent coverage are made by employees and retirees. As described in Note 11, coverage is also extended to certain individuals as an other postemployment benefit. The Plan is administered by a third party who is responsible for the processing of claims and administration of cost containment. Health care is also made available through contractual agreements with health maintenance organizations (HMO). Monthly premium payments transfer the risk for health coverage to the Plan. The Plan does not assume risk for HMO contracts.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and copayment requirements. The Plan disallows claims in excess of a lifetime maximum of \$2,000,000.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the Plan's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1996-97	\$ 117,137	\$ 573,514	\$ 579,317	\$ 111,334
1997-98	111,334	643,915	643,544	111,705

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, an internal service fund, to all members of the Teachers' and State Employees' Retirement System who have completed at least one full calendar year of membership in the System. Membership includes employees of the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the

member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of \$25,000 and to a maximum of \$50,000.

Death benefits are funded by actuarially based employer contributions that are established in the Appropriation Bill by the General Assembly. The State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs contributed .16% of active employees' salaries to fund the Death Benefit Plan for the calendar year ended December 31, 1997.

These benefits are established by Chapter 135, Section 5(1), of the General Statutes and may be amended only by the North Carolina General Assembly. Claims liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1996-97	\$ 2,422	\$ 20,624	\$ 20,626	\$ 2,420
1997-98	2,420	22,301	22,441	2,280

3. Disability Income Plan of North Carolina

Short-term and long-term disability benefits are provided to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program through the Disability Income Plan of North Carolina (DIPNC), an internal service fund. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. As discussed in Note 11, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

Claim liabilities for long-term disability benefits are actuarially estimated using the one-year term cost method.

NOTES TO THE FINANCIAL STATEMENTS

These liabilities represent the present value of future claim payments obligated to members who have become disabled. The claim liabilities are separated into the following two classifications: (1) approved claim liabilities are for long-term disabilities that have occurred, have been approved, and are in long-term payment status; and (2) incurred but not reported (IBNR) liabilities are for disabilities that have occurred but are not in payment status. The IBNR liabilities are estimated based on the historical claims experience of DIPNC.

Significant actuarial assumptions used to estimate claim liabilities are presented in Note 11. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1996-97	\$ 172,971	\$ 83,509	\$ 45,098	\$ 211,382
1997-98	211,382	65,244	44,334	232,292

NOTES TO THE FINANCIAL STATEMENTS**NOTE 12: RISK MANAGEMENT AND INSURANCE (continued)****C. Other Risks****1. Fire and Other Property Losses**

The State Property Fire Insurance Fund (the Fund), an internal service fund of the State, was created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Agencies of the State can purchase extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents through the Fund. For those that elect to receive any of this other coverage, the Fund charges premiums discounted from industry manual rates. The Fund insures fire losses up to \$1.1 million per occurrence and extended coverage losses up to \$100,000 per building and \$500,000 per occurrence, except for wind losses by named storms in designated coastal counties, which are covered up to 1% of the value for each location up to a maximum of \$2 million per occurrence. All losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft, which carries a \$1,000 per occurrence deductible.

The Fund purchases excess insurance from a private insurer to cover losses over the amounts insured by the Fund. If aggregate uninsured extended coverage losses sustained by the Fund, other than wind losses by named storms, reach \$2 million in any one annual period, the Fund is responsible for subsequent losses as follows: a \$50,000 per occurrence deductible for wind losses other than by named storms, and a \$10,000 per occurrence deductible for other extended coverage losses. If aggregate uninsured fire and other property losses sustained by the Fund reach \$5 million in any one annual period, the Fund is responsible for a \$50,000 per occurrence deductible for subsequent losses. Settled claims have not exceeded coverage in any of the past three fiscal years.

Claims are paid when the Council of State approves the request for payment. Claims costs are recognized when they are approved by the Council of State and are outstanding for payment; when known estimates of losses are waiting to be submitted to the Council of State for approval; or when a loss occurs and can be reasonably estimated. Claims payable at June 30, 1998 are disclosed on the balance sheet as a combination of claims payable of \$344,820 and due to other funds of \$275,200. Changes in the balances of claims liabilities during the current and prior fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
1996-97	\$ 2,129	\$ 4,316	\$ 3,894	\$ 2,551
1997-98	2,551	324	2,255	620

2. Medical Malpractice Protection**a. Professional Liability Insurance for State Medical Personnel**

All agencies of the State and participating component units are insured for tort claims up to \$150,000 under the authority of the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. Organizations within the reporting entity carry excess commercial liability insurance to supplement the coverage provided by the State Torts Act; however, claims involving medical malpractice are generally excluded from this coverage. All universities except for the University of North Carolina at Chapel Hill Medical School (UNC-CH Medical School) and UNC Hospitals purchase commercial liability insurance. The UNC-CH Medical School and UNC Hospitals are self-insured through the Liability Insurance Trust Fund, which is described in detail below. Chapter 443, Section 11.32, of the 1997 Session Laws of North Carolina authorized the Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction to provide medical liability coverage on behalf of employees licensed to practice medicine or dentistry; all licensed physicians who are faculty members of the University of North Carolina who work on contract for the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services for incidents that occur in Division programs; and on behalf of medical residents from the University of North Carolina who are in training at institutions operated by the Department of Health and Human Services. The extent of coverage is a maximum of \$1 million for each individual incident and does not affect current coverage under the State Tort Claims Act. The Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction purchase commercial professional liability insurance for their

NOTES TO THE FINANCIAL STATEMENTS

medical staff. Settled claims have not exceeded coverage in any of the past three fiscal years.

Insurance coverage varies depending upon the amount of coverage and the type of policy. Typically the amount of primary coverage for medical liability is \$1 million per individual, claim, or incidence, and \$3 million total or aggregate. Many departments and institutions maintain excess policies to provide additional coverage above that provided by the primary policy for medical liability. The policies are written on a claims made or occurrence basis, with the majority of the policies being claims made. The claims liabilities are not measurable.

b. Self-Insurance through the Liability Insurance Trust Fund

The Liability Insurance Trust Fund (Trust Fund) was created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978 to provide medical malpractice protection for program participants and individual health care practitioners working as employees, agents, or officers of the program participants. The program participants are University of North Carolina Hospitals at Chapel Hill and the University of North Carolina at Chapel Hill Physicians and Associates, both of whom are a part of the University of North Carolina system, which is a component unit of the reporting entity. Coverage is self-funded by contributions from participants and investment income. Contributions are based on the actuarially determined funding level for a given plan year.

Coverage is provided on an occurrence basis. The Trust Fund limits the coverage per occurrence to \$5 million with no limitation in the aggregate. In the event the Trust Fund has insufficient funds to pay existing and future claims, it has the authority to borrow necessary amounts up to \$30 million. Any such borrowing would be repaid from the assets and revenues of program participants. No borrowings have been made under this authority to date.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of all losses and loss adjustment expenses, including losses and loss adjustment expenses incurred but not yet reported, which are unpaid at the balance sheet date. The claims liability of \$30,868,020 and \$35,850,822 is the present value of the aggregate actuarially determined claims liability of \$33,099,157 and \$37,980,302, discounted at rates ranging from 6% to 7%, at June 30, 1997 and 1998, respectively. These estimates are reviewed annually, and as adjustments become necessary, such adjustments are reflected in current operations. Claims against participants are paid from the corpus of the Trust Fund. Changes in the Trust Fund's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year</i>	<i>Current-Year Claims and Changes in</i>	<i>Claim</i>	<i>Balance at Fiscal</i>
	<i>Liability</i>	<i>Estimates</i>	<i>Payments</i>	<i>Year-End</i>
1996-97	\$ 28,964	\$ 7,038	\$ 5,134	\$ 30,868
1997-98	30,868	8,911	3,928	35,851

3. Automobile Liability Insurance

The State is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle, which includes vehicles held by the State's participating component units. The State is self-insured for the first \$250,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$250,000. The liability limits for losses incurring in-state are \$150,000 per claimant and \$5 million per occurrence. For losses incurring out-of-state, the limits are \$1 million per claimant and \$5 million per occurrence. Covered losses include those that occur with vehicles that are not on a stationary track or rail, and federal vehicles when the Governor calls out the National Guard.

Agencies of the State and participating component units using state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred. The private insurer processes all claims and sets up a reserve for amounts expected to be paid for claims. Claims are paid by the private insurer after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

4. Public Officers' and Employees' Liability Insurance

In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units except for doctors and dentists. The policy provides \$11 million excess insurance over the \$150,000 statutory limit payable for any one claim under the Tort Claims Act. Since each state agency or component unit is responsible for funding any tort claims of \$150,000 or less from their budget, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

NOTES TO THE FINANCIAL STATEMENTS**NOTE 12: RISK MANAGEMENT AND INSURANCE (continued)****5. Workers' Compensation Program**

The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job. All employees of the State and its component units are included in the Program. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. Payments of all medical benefits are subject to approval based on a fee schedule established by the North Carolina Industrial Commission (NCIC). Loss of wages and disability benefits are payable based on 66 2/3% of an employee's average weekly salary subject to a statutory compensation rate minimum and maximum established annually by the NCIC. Death benefits are payable for 400 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 400 weeks.

The responsibility for claiming compensation is on the injured employee. If the injured employee or his representative does not notify the employer within 30 days from the date of injury, the employer can refuse compensation. A claim must be filed with the NCIC by either the employee or the employer within two years from the date of knowledge thereof; otherwise the claim is barred by law and no further compensation is allowable. When an employee is injured, the employer's primary responsibility is to arrange for and provide the necessary treatment for any work-related injury. The employer tries to provide the best possible medical care for injured employees to help them reach maximum medical improvement and return to work as soon as possible.

On April 1, 1996, the Workers' Compensation Cost Containment Pilot Project was developed by the Office of State Budget and Management and the Office of State Personnel by authority of Chapter 507, Section 11.1 of the 1995 Session Laws. Seventeen state agencies and universities volunteered to participate in the Project. A third-party administrator was selected in a bidding process to administer workers' compensation claims for these seventeen agencies and universities. The seventeen agencies and universities contribute to a fund set up in the Office of the State Controller, which is administered by the Office of State Personnel, to cover their workers' compensation claims. The administrator draws from this fund on a daily basis to make medical and indemnity payments on behalf of the State. An administrative fee based on a percentage of cost savings also is drawn from the fund by the administrator. The workers' compensation cost of the seventeen project agencies is included in the schedule below. For the other non-participating agencies and universities, each employer accepts or denies liability for the reporting entity and is responsible for monitoring and

processing the claims. The employer is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act.

The State and its component units are self-insured for workers' compensation. Each state agency and participating component unit is responsible for paying claims out of its individual budget. Budgets for workers' compensation for most state agencies and participating component units are based on the prior year's loss experience. Since the related liability is not measurable, claim costs are recognized when paid. The Department of Transportation is the only state agency or component unit that sets up a reserve for claims. For the year ended June 30, 1998, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	\$ 35,917
University of North Carolina system	3,295
All other component units	<u>72</u>
Total	<u>\$ 39,284</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 13: SEGMENT INFORMATION FOR ENTERPRISE FUNDS

Segment information for the State's enterprise funds for the year ended June 30, 1998 is presented below (dollars in thousands).

	<i>Public School Insurance</i>	<i>N.C. State Fair</i>	<i>USS North Carolina Battleship Commission</i>	<i>Agricultural Farmers Market</i>	<i>Workers' Comp.</i>	<i>Indian Cultural Tourist Center</i>	<i>Other Funds</i>	<i>Total</i>
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	
Operating revenues.....	\$ 9,080	\$ 7,081	\$ 2,111	\$ 854	\$ 3,320	\$ 3	\$ 1,269	\$ 23,718
Depreciation/amortization.....	—	636	158	623	—	9	32	1,458
Operating income (loss).....	(1,355)	(227)	218	(685)	(941)	(6)	(106)	(3,102)
Operating transfers in.....	—	—	—	121	—	—	169	290
Operating transfers (out).....	—	(125)	—	(2)	—	—	—	(127)
Net income (loss).....	(1,355)	(246)	381	(551)	(941)	(6)	113	(2,605)
Current capital contribution...	—	—	—	—	4,500	—	1,849	6,349
Fixed assets:								
Additions.....	—	(607)	(76)	(614)	—	—	1,815	518
Deletions.....	—	—	51	—	—	—	—	51
Current assets.....	54,723	4,670	1,605	716	12,013	28	442	74,197
Current liabilities.....	22,447	632	138	86	6,037	—	61	29,401
Net working capital.....	32,276	4,038	1,467	630	5,976	28	381	44,796
Total assets.....	54,723	13,413	4,506	10,785	12,013	507	2,256	98,203
Total equity (deficit).....	32,276	12,781	4,278	10,699	5,976	507	2,195	68,712

Principal enterprise fund activities:

[1] The **Public School Insurance** fund provides fire, theft and vandalism insurance for public school buildings and contents and offers risk management services.

[2] The **N.C. State Fair** in Raleigh provides annual competitive exhibition of North Carolina agricultural products as well as rural arts and crafts.

[3] The **USS North Carolina Battleship Commission** in Wilmington is open for public exhibition all year. The Commission administers the maintenance and exhibition costs of the battleship.

[4] The **Agricultural Farmers Market** in Raleigh provides a site where state farmers can sell fresh produce and other agricultural products directly to the public.

[5] The **Workers' Compensation Fund**, provides benefits to volunteer safety workers for workers' compensation. This fund is administered by the N.C. Department of Insurance.

[6] The **Indian Cultural Tourist Center**, located in Robeson County, is to promote and preserve the culture of the Indian people.

[7] **Other Governmental Enterprise Funds** have been organized to operate concession stands, bookstores, and vending and sales desks.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 14: COMPONENT UNITS — CONDENSED FINANCIAL INFORMATION

Condensed financial statements for the component unit funds as of and for the fiscal year ended June 30, 1998 are presented below (dollars in thousands).

Condensed Balance Sheet Component Units - Proprietary Funds

	N.C. Housing Finance Agency	State Education Assistance Authority	N.C. State Ports Authority	Centennial Authority	North Carolina Railroad Company	N.C. Low Level Radio- Active Waste Management Authority	N.C. Global TransPark Authority	MCNC	Other Component Units	Total Proprietary Component Units
Current assets										
Due to primary government.....	\$ —	\$ 13,299	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 195	\$ —	\$ 13,494
Other.....	39,103	463,732	35,615	146,963	6,412	632	28,529	8,635	70,446	800,067
Non-current assets.....	1,089,767	424,390	48	—	—	—	—	167	7,960	1,522,332
Fixed assets.....	431	631	116,975	38,551	7,843	—	4,209	9,934	9,800	188,374
Total Assets.....	<u>\$ 1,129,301</u>	<u>\$ 902,052</u>	<u>\$ 152,638</u>	<u>\$ 185,514</u>	<u>\$ 14,255</u>	<u>\$ 632</u>	<u>\$ 32,738</u>	<u>\$ 18,931</u>	<u>\$ 88,206</u>	<u>\$ 2,524,267</u>
Current liabilities										
Due to primary government.....	\$ 14	\$ —	\$ —	\$ —	\$ —	\$ 1	\$ 3	\$ —	\$ 1	\$ 19
Other.....	112,887	202,312	3,784	50,634	380	317	5,607	7,228	18,021	401,170
Long-term liabilities										
Due to primary government.....	—	—	—	—	—	16,824	—	—	—	16,824
Advance from primary government.....	—	—	—	—	—	33,054	25,000	—	—	58,054
Bonds payable.....	883,374	294,114	12,870	59,890	—	—	—	—	—	1,250,248
Other.....	—	—	672	—	—	—	—	794	6,421	7,887
Fund equity.....	133,026	405,626	135,312	74,990	13,875	(49,564)	2,128	10,909	63,763	790,065
Total liabilities and fund equity.....	<u>\$ 1,129,301</u>	<u>\$ 902,052</u>	<u>\$ 152,638</u>	<u>\$ 185,514</u>	<u>\$ 14,255</u>	<u>\$ 632</u>	<u>\$ 32,738</u>	<u>\$ 18,931</u>	<u>\$ 88,206</u>	<u>\$ 2,524,267</u>

Condensed Statement of Revenues, Expenses and Changes in Fund Equity Component Units - Proprietary Funds

	N.C. Housing Finance Agency	State Education Assistance Authority	N.C. State Ports Authority	Centennial Authority	North Carolina Railroad Company	N.C. Low Level Radio- Active Waste Management Authority	N.C. Global TransPark Authority	MCNC	Other Component Units	Total Proprietary Component Units
Operating revenues.....	\$ 83,986	\$ 62,094	\$ 27,404	\$ —	\$ 3,232	\$ —	\$ —	\$ 32,749	\$ 3,171	\$ 212,636
Operating expenses										
Depreciation/amortization.....	136	394	7,205	—	9	—	38	9,570	818	18,170
All other.....	71,833	42,146	22,010	390	2,471	—	1,458	32,263	9,968	182,539
Operating income.....	12,017	19,554	(1,811)	(390)	752	—	(1,496)	(9,084)	(7,615)	11,927
Operating transfers from component units.....	—	9,531	—	—	—	—	—	—	—	9,531
Operating transfers from primary government.....	2,314	13,299	—	—	—	—	922	4,500	92,586	113,621
Operating transfers to primary government.....	(50)	—	(1)	—	—	—	—	—	—	(51)
Other nonoperating revenues (expenses).....	—	36	379	4,255	4,339	(3,575)	507	(11,534)	(60,677)	(66,270)
Net income (loss).....	14,281	42,420	(1,433)	3,865	5,091	(3,575)	(67)	(16,118)	24,294	68,758
Excess of revenues over (under) expenditures from governmental operations.....	(1,086)	—	—	—	—	—	—	—	—	(1,086)
Fund equity - July 1.....	126,206	363,206	120,502	65,943	8,784	(45,578)	2,201	25,723	40,933	707,920
Other changes in equity.....	(6,375)	—	16,243	5,182	—	(411)	(6)	1,304	(1,464)	14,473
Fund equity - June 30.....	<u>\$ 133,026</u>	<u>\$ 405,626</u>	<u>\$ 135,312</u>	<u>\$ 74,990</u>	<u>\$ 13,875</u>	<u>\$ (49,564)</u>	<u>\$ 2,128</u>	<u>\$ 10,909</u>	<u>\$ 63,763</u>	<u>\$ 790,065</u>

NOTES TO THE FINANCIAL STATEMENTS

Condensed Balance Sheet
Component Units - College and University Funds

	<i>University Funds</i>	<i>Community Colleges Funds</i>	<i>Total College and University Funds</i>
Assets			
Due from other funds.....	\$ 66,091	\$ 546	\$ 66,637
Due from component units.....	1,753	—	1,753
Due from primary government.....	5,148	46,140	51,288
Fixed assets.....	4,637,257	1,135,533	5,772,790
Other.....	4,355,285	236,478	4,591,763
Total assets.....	<u>\$ 9,065,534</u>	<u>\$ 1,418,697</u>	<u>\$ 10,484,231</u>
Liabilities			
Due to other funds.....	\$ 66,091	\$ 546	\$ 66,637
Due to component units.....	1,640	—	1,640
Due to primary government.....	1,227	2,459	3,686
Bonds payable.....	838,993	—	838,993
Notes payable.....	42,315	1,205	43,520
Other.....	1,591,513	88,804	1,680,317
Total liabilities.....	<u>2,541,779</u>	<u>93,014</u>	<u>2,634,793</u>
Fund equity			
Total fund equity.....	<u>6,523,755</u>	<u>1,325,683</u>	<u>7,849,438</u>
Total liabilities and fund equity.....	<u>\$ 9,065,534</u>	<u>\$ 1,418,697</u>	<u>\$ 10,484,231</u>

Condensed Statement of Revenues, Expenditures, and Changes in Fund Equity
Component Units - College and University Funds

	<i>University Funds</i>	<i>Community Colleges Funds</i>	<i>Total College and University Funds</i>
Revenues.....	\$ 3,197,818	\$ 459,410	\$ 3,657,228
Expenditures.....	4,242,889	986,806	5,229,695
Operating transfers from primary government.....	1,654,249	619,626	2,273,875
Operating transfers to primary government.....	(16,572)	—	(16,572)
Operating transfers to component units.....	(9,531)	—	(9,531)
Net increase in fund equity.....	583,075	92,230	675,305
Fund equity - July 1.....	5,946,656	1,231,804	7,178,460
Other changes in equity.....	(5,976)	1,649	(4,327)
Fund equity - June 30.....	<u>\$ 6,523,755</u>	<u>\$ 1,325,683</u>	<u>\$ 7,849,438</u>

Condensed Statement of Current Funds Revenues, Expenditures, and Transfers
Component Units - College and University Funds

	<i>University Funds</i>	<i>Community Colleges Funds</i>	<i>Total College and University Funds</i>
Revenues.....	\$ 2,019,398	\$ 242,435	\$ 2,261,833
Expenditures.....	3,311,096	807,900	4,118,996
Transfers and Additions (Deductions):			
Excess of restricted receipts over transfers to revenues.....	13,618	2,250	15,868
Refunded to grantors.....	(856)	—	(856)
Mandatory transfers.....	(61,171)	(2)	(61,173)
Non-mandatory transfers.....	(10,896)	(3,074)	(13,970)
Interinstitutional transfers.....	(4,323)	—	(4,323)
Operating transfers from primary government.....	1,430,423	568,296	1,998,719
Operating transfers to primary government.....	(1,336)	—	(1,336)
Operating transfers to component units.....	(9,531)	—	(9,531)
Net increase in fund equity.....	<u>\$ 64,230</u>	<u>\$ 2,005</u>	<u>\$ 66,235</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 15: RESERVED FUND BALANCES

The State and its component units' reserved fund balances represent those portions of fund balance that are (1) not available for appropriation or expenditure, which includes loans receivable and long-term portion of advances to other funds, or (2) fund balances that are legally segregated for a specific use.

The primary government's reserved fund balances at June 30, 1998, are (dollars in thousands):

	Governmental Fund Types			Fiduciary Funds				
	General	Special Revenue	Capital Projects	Expendable Trust	Non-expendable Trust	Pension Trust	Investment Trust	Fiduciary Totals
Inventories.....	\$ 48,997	\$ 25,630	\$ —	\$ 1,132	\$ —	\$ —	\$ —	\$ 1,132
Reserved for specific encumbrances.....	260,663	10,094	—	—	—	—	—	—
Retirees' health premiums.....	253,500	—	—	—	—	—	—	—
Energy conservation.....	31,102	—	—	1,872	—	—	—	1,872
Investments.....	43	—	—	—	—	—	—	—
Other reserves.....	32,431	2,557	—	610	—	—	—	610
Medicaid programs.....	146,756	—	—	—	—	—	—	—
Advances to component unit.....	94,054	—	—	25,000	—	—	—	25,000
Repairs and renovations.....	174,190	—	—	—	—	—	—	—
Clean Water Management Trust Fund.....	47,398	—	—	—	—	—	—	—
Intangible tax refunds.....	9,260	—	—	—	—	—	—	—
Federal retirees' refund account.....	10,714	—	—	—	—	—	—	—
DPI allocation.....	55,028	—	—	—	—	—	—	—
Disproportionate share.....	35,447	—	—	—	—	—	—	—
Work First.....	19,541	—	—	—	—	—	—	—
Vacation, sick leave.....	—	32,599	—	—	—	—	—	—
Notes receivable.....	497	112,371	—	—	255,487	—	—	255,487
Public School Building Capital Needs.....	—	28,107	—	—	—	—	—	—
Critical School Facility Needs.....	—	5,010	—	—	—	—	—	—
Prepaid items.....	—	1,290	—	—	—	—	—	—
Capital projects.....	—	—	88,871	—	—	—	—	—
Claims and benefits.....	—	—	—	1,968,548	—	—	—	1,968,548
Loan and grant commitments.....	—	722,646	—	—	49,498	—	—	49,498
Abandoned property.....	—	—	—	180,127	—	—	—	180,127
Political parties.....	—	—	—	125	—	—	—	125
Wildlife endowment.....	—	—	—	—	41,183	—	—	41,183
Investment pool participants.....	—	—	—	—	—	—	306,610	306,610
Employees' pension benefits.....	—	—	—	—	—	49,334,679	—	49,334,679
Total Fund Balances Reserved.....	<u>\$ 1,219,621</u>	<u>\$ 940,304</u>	<u>\$ 88,871</u>	<u>\$ 2,177,414</u>	<u>\$ 346,168</u>	<u>\$ 49,334,679</u>	<u>\$ 306,610</u>	<u>\$ 52,164,871</u>

The component units' reserved fund balances at June 30, 1998, are (dollars in thousands):

Restricted Funds	University	Community Colleges	Total College and University Funds
Loans.....	\$ 96,222	\$ 1,042	\$ 97,264
Endowments.....	695,449	14,845	710,294
Revenue bonds.....	69,046	—	69,046
Restricted funds.....	<u>550,471</u>	<u>133,754</u>	<u>684,225</u>
Total Fund Balances Reserved.....	<u>\$ 1,411,188</u>	<u>\$ 149,641</u>	<u>\$ 1,560,829</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 16: FUND EQUITY RECLASSIFICATIONS AND RESTATEMENTS

As a result of review during the current reporting period, certain funds were reclassified from their June 30, 1997 presentation to more appropriate fund types. The effects of these reclassifications appear in the "Entity Changes/Fund Reclassification" column. Some fund equity balances as of July 1, 1997, are restated for certain accounting changes or adjusted for the correction of errors in the reported balances of the fiscal year ended June 30, 1997. These changes are shown in the "Prior Year Adjustments and Restatements" column. The following table summarizes the above changes as they appear in the accompanying financial statements (dollars in thousands).

As referred to in Note 1, *Summary of Significant Accounting Policies*, the State implemented GASB Statement No. 31, *Accounting and Financial Reporting for*

Certain Investments and for External Investment Pools, and GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, for the fiscal year ended June 30, 1998.

On April 1, 1998, the State loaned \$61 million to the North Carolina Railroad Company (Railroad), a for-profit corporation, for the purpose of acquiring the non-State owned outstanding common stock shares of the Railroad. This transaction resulted in the State owning 100% of the outstanding common stock shares of the Railroad. Based on the application of the criteria related to financial accountability and benefit/burden found in GASB Statement No. 14, *The Financial Reporting Entity*, the Railroad is now classified as a proprietary component unit of the State.

	June 30, 1997 Fund Equity as Previously Reported	GASB 31 Implemen- tation	GASB 32 Implemen- tation	Entity Changes/ Fund Reclass- ification	July 1, 1997 Fund Equity as Reported	Prior Year Adjustments/ Restatements	July 1, 1997 Fund Equity as Restated
Primary Government							
General Fund.....	\$ 1,703,901	\$ 3,643	\$ —	\$ (126)	\$ 1,707,418	\$ 384	\$ 1,707,802
Special Revenue.....	1,937,374	84	—	(1,000)	1,936,458	(210)	1,936,248
Capital Projects.....	280,444	—	—	—	280,444	—	280,444
Enterprise.....	63,970	872	—	126	64,968	—	64,968
Internal Service.....	639,849	21,573	—	—	661,422	573	661,995
Expendable Trust Funds.....	2,911,845	11,844	425,514	—	3,349,203	(1)	3,349,202
Nonexpendable Trust Funds.....	354,802	2,935	—	1,000	358,737	(20)	358,717
Pension Trust Funds.....	41,649,289	—	—	—	41,649,289	—	41,649,289
Investment Trust Fund.....	—	285,380	—	—	285,380	—	285,380
Total Primary Government.....	49,541,474	326,331	425,514	—	50,293,319	726	50,294,045
Component Units							
Proprietary Funds.....	691,620	7,516	—	8,784	707,920	(7,452)	700,468
College and University:							
University funds.....	5,890,171	56,485	—	—	5,946,656	(5,922)	5,940,734
Community colleges funds.....	1,230,854	950	—	—	1,231,804	1,649	1,233,453
Total Component Units.....	7,812,645	64,951	—	8,784	7,886,380	(11,725)	7,874,655
Total Reporting Entity.....	\$ 57,354,119	\$ 391,282	\$ 425,514	\$ 8,784	\$ 58,179,699	\$ (10,999)	\$ 58,168,700

NOTE 17: RESIDUAL EQUITY TRANSFERS

Residual equity transfers out exceed residual equity transfers in by \$31.21 million due to the following transactions: (1) \$9.943 million transferred out from the State Highway Fund to the North Carolina Railroad Company (*proprietary component unit*, fiscal year ended December 31, 1997). This transfer is not reflected on the State's component unit financial statements for the fiscal year ended June 30, 1998. (2) \$11.384 million transferred out from the Capital Projects Fund and \$4.859 million transferred out from the General Fund to the State Ports Authority (*proprietary component unit*), recorded by the Authority as an increase in contributed capital. (3) \$4.5 million transferred out from the General Fund to the Workers' Compensation Fund (*Enterprise Fund*), recorded by the

Workers' Compensation Fund as an increase in contributed capital. (4) \$500 thousand transferred out from the General Fund to the N.C. Agricultural Finance Authority (*proprietary component unit*), recorded by the Authority as an increase in contributed capital. (5) \$90 thousand deficit transferred out of the General Fund to the *Enterprise Funds - Other* recorded in the *Enterprise Funds - Other* as a decrease in contributed capital. \$114 thousand transferred out from the *Expendable Trust Funds - Other* recorded in the *Enterprise Funds - Other* as an increase in contributed capital.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 18: COMMITMENTS AND CONTINGENCIES

A. No Commitment Debt

The State, by action of the General Assembly, created the North Carolina Medical Care Commission which is authorized to issue tax-exempt bonds and notes to finance construction and equipment projects for nonprofit and public hospitals, nursing homes, continuing care facilities for the elderly and related facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each entity is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2028, the outstanding principal of such bonds and notes as of June 30, 1998, was \$2.497 billion with interest rates varying from 2.30 % to 8.75 %.

The State, by action of the General Assembly, created the North Carolina Educational Facilities Finance Agency which is authorized to issue tax-exempt bonds and notes to finance facilities and structures at private institutions of higher learning. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2028, the outstanding principal of such bonds and notes as of June 30, 1998, was \$539.9 million with variable interest rates.

The State, by action of the General Assembly, created the North Carolina Industrial Facilities and Pollution Control Financing Authority which is authorized to issue tax-exempt bonds and notes to provide funds to be loaned by the Authority to finance industrial and manufacturing facilities, pollution control facilities for industry (in connection with manufacturing) where there is a favorable impact on employment or pollution control commensurate with the size and cost of the facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2009, the outstanding

principal of such bonds and notes as of June 30, 1998, was \$8.8 million with variable interest rates.

B. Litigation

Bailey v. State and Patton v. State -- State Income Tax Refunds for Retired State and Federal Workers. *Bailey* is a class action involving the claim that the General Assembly acted unconstitutionally in 1989 when it repealed the full exemption from State income tax for the pensions of retired state and local government employees. This action was taken in response to the United States Supreme Court decision in *Davis v. Michigan Department of Treasury* that the intergovernmental tax immunity doctrine prohibits states from taxing pensions of state and federal retirees differently. *Patton* is a class action involving the claim that the General Assembly's 1989 legislation did not cure the defects in the State's taxation of the pensions of state and federal retirees.

The State defended *Bailey* on the grounds that the people of the State in enacting Article V, Sec. 1 of the State Constitution ("The power of taxation shall . . . never be surrendered, suspended or contracted away") vested in the General Assembly the full discretion to change tax exemptions as conditions warranted. On May 8, 1997, the North Carolina Supreme Court chose not to apply Article V, Sec. 1 of the State Constitution and held that the General Assembly acted unconstitutionally when it repealed the full tax exemption for state and local government retirees who had "vested" interests in their pensions. Overturning a long line of prior decisions, the Court further held that the State was liable to make full refunds of all state income taxes paid by these retirees since 1989 regardless of whether they had followed required procedures.

One potential result of the *Bailey* decision was to recreate a difference in the treatment of the pensions of federal and state retirees for the period since 1989, and thus make the State liable to federal retirees in *Patton*. Given the Supreme Court's decision in *Bailey* and its potential impact in *Patton*, the General Assembly agreed to settle all claims for refunds by all state and federal retirees for \$799 million. The North Carolina General Assembly has reserved \$400 million to pay the first installment of the settlement. This amount has been reported in the financial statements as a liability of the General Fund. The remaining \$399 million has been reported as a liability in the General Long-term Obligations Account Group.

Faulkenbury v. Teachers' and State Employees' Retirement System, Peele v. Teachers and State Employees' Retirement System and Woodard v. Local Government Employees' Retirement System. Plaintiffs are disability retirees who brought class actions in state court challenging

NOTES TO THE FINANCIAL STATEMENTS

changes in the formula for payment of disability retirement benefits and claiming impairment of contract rights, breach of fiduciary duty, violation of other federal constitutional rights, and the violation of state constitutional and statutory rights. Their claims were heard in the Superior Court of Wake County in May, 1995. The trial court ruled in plaintiffs favor, and the State appealed to the North Carolina Supreme Court. The Supreme Court affirmed the judgment of the trial court in favor of the plaintiffs on April 11, 1997. The court concluded that at the time plaintiffs' rights to pensions became vested, the law provided that they would have disability retirement benefits calculated in a certain way; and that these were contractual rights that plaintiffs earned and that could not be taken away by the Legislature. The trial court is now supervising the payment of back benefits to class members. The estimated amount of back benefits due class members is \$126 million. This amount has been reported in the financial statements as a liability of the Teachers' and State Employees' Retirement System. As of September 20, 1998, approximately one-half of this amount has been paid and the remainder is expected to be paid no later than June 30, 1999.

Leandro et al v. State of North Carolina and State Board of Education. On May 25, 1994, students and boards of education in five counties in the State filed suit in Superior Court requesting a declaration that the State's public education system does not meet standards established by the State Constitution. In January, 1995, the trial court refused to dismiss the suit and the State appealed. Subsequently, the North Carolina Court of Appeals reversed the trial court and dismissed the suit. On July 24, 1997, the North Carolina Supreme Court reversed the Court of Appeals. The Court concluded that the North Carolina Constitution guarantees "every child of this state an opportunity to receive a sound basic education," and remanded that issue to the trial court for further proceedings.

The Attorney General's Office believes that there are sound legal arguments to support the State's position on remand that plaintiffs are receiving an opportunity to obtain a sound basic education.

Smith v. State – Intangibles tax refunds to non-protesting taxpayers. On February 21, 1996, the U.S. Supreme Court declared North Carolina's intangibles tax unconstitutional. Subsequently, the State made refunds of intangible taxes paid by all persons who had complied with the provisions of G.S. 105-267 for obtaining refunds of unconstitutional taxes. The *Smith* case is an action aimed principally at recovering intangibles tax refunds for taxpayers who failed to comply with the provisions of G.S. 105-267. Prior to the N.C. Supreme Court's 1997 decision in *Bailey*, it was firmly established that compliance with G.S. 105-267 was necessary to obtain a refund and on that basis the trial court in *Smith* had denied the claims of non-protesting taxpayers for refunds. As noted above, however, the 1997 *Bailey* decision

overturned the long line of cases on which the trial court had relied. On December 4, 1998, the Supreme Court ruled that North Carolina will have to pay refunds to non-protesters who paid intangibles taxes. Refunds to non-protesters will total approximately \$233 million plus interest of approximately \$100 million. The total liability has been reported in the financial statements in the General Long-term Obligations Account Group.

Other Litigation. The State is involved in numerous other claims and legal proceedings, many of which normally recur in governmental operations. A review of the status of outstanding lawsuits involving the State by the North Carolina Attorney General did not disclose other proceedings that are expected to have a material adverse effect on the financial position of the State.

C. Federal Grants

Under the terms of federal grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures under the terms of the grants. Such audits could lead to reimbursement to the grantor agencies, although it is believed that disallowances, if any, will be immaterial.

D. Highway Construction

The State may be liable for approximately \$63.7 million to contractors for highway construction claims that the State has contested. The State may also be liable for an additional \$38.9 million in contested rights-of-way acquisition costs to property owners in condemnation proceedings. These costs have not been included in project-to-date costs. Also, the State is contingently liable for outstanding contractors' claims in the amount of \$9.7 million.

E. USDA-Donated Commodities

The State has custodial responsibility for \$1.937 million of U.S. Department of Agriculture donated food commodities for which the State is liable in the event of loss.

F. Construction and Other Commitments

At June 30, 1998, the State had commitments of \$1,186.0 million for construction of highway facilities. Of this amount, \$954 million relates to the Highway Fund, and \$232 million relates to the Highway Trust Fund. The other commitments for construction and improvements of state government facilities totaled \$196.7 million (including \$121.2 million for the Department of Environment and Natural Resources and \$35.8 million for the Department of Administration).

NOTES TO THE FINANCIAL STATEMENTS

NOTE 18: COMMITMENTS AND CONTINGENCIES (continued)

At June 30, 1998, the University of North Carolina system (component unit) had outstanding construction commitments of \$301.8 million (including \$100.0 million for UNC Hospitals, \$50.2 million for University of North Carolina - Chapel Hill, and \$32.2 million for Appalachian State University).

At June 30, 1998, community colleges (component units) had outstanding construction commitments of \$49.6 million

(including \$8.8 million for Isothermal Community College, \$5.1 million for Richmond Community College, and \$4.7 million for Guilford Technical Community College).

At June 30, 1998, proprietary component units had outstanding commitments of \$7.7 million (including \$4.0 million for North Carolina State Ports Authority and \$3.0 million for Global TransPark).

NOTE 19: SUBSEQUENT EVENTS

State Education Assistance Authority. On September 23, 1998, the Authority issued \$240 million taxable Guaranteed Student Loan Revenue Bonds (equal amounts of Series F1 and F2) with an initial interest rate of 5.6%. Since these are auctioned rate bonds and are auctioned monthly, the rate will fluctuate as market conditions change.

North Carolina State University. On July 24, 1998, the University signed a commitment letter with NationsBank, N.A. in the amount of \$14 million to interim finance the cost of construction of the Partners III Building and a parking deck on Centennial Campus. To date, the loan documents have not been signed.

On September 11, 1998, the University of North Carolina Board of Governor's ratified the issuance of bonds for a system wide tax exempt bond financing. The University intends to borrow approximately \$29.4 million through the financing.

On September 30, 1998, the Board of Trustees of the University ratified the commitment the Chancellor made on September 21, 1998 to fund an additional \$6 million to Centennial Authority for the construction of the Entertainment and Sports Arena. The University will fund the commitment from a loan to be repaid from revenue earned at Arena events.

Statewide Bond Referendum. On November 3, 1998, North Carolina voters approved \$800 million of new debt to finance grants and loans to local government units for water supply systems, wastewater collection systems, wastewater treatment works, and water conservation and water reuse projects; and an additional \$200 million of new debt to finance grants, loans, or other financing to public or private entities for construction of natural gas facilities.

NOTE 20: EVENTS SUBSEQUENT TO THE ISSUANCE OF THE ORIGINAL INDEPENDENT AUDITOR'S REPORT

GASB Technical Bulletin 99-1. On March 29, 1999, the Governmental Accounting Standards Board (GASB) issued Technical Bulletin (TB) 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. The amendment, among other things, provides that required year 2000 disclosures may be reported as required supplementary information. Retroactive application of TB 99-1 is permitted. The State of North Carolina has elected to apply TB 99-1 retroactively for its 1998 general-purpose financial statements, and to present the year 2000 disclosures as required supplementary information on pages 108 and 109.

Tobacco Settlement. On November 16, 1998, the nine states' Attorneys General and the major tobacco companies signed a proposed settlement that reimburses states for smoking-related medical expenses paid through Medicaid and other health care programs. North Carolina could receive \$4.6

billion over the next 25 years. On March 16, 1999, the General Assembly established a foundation, to comply with a court consent decree, to help communities in North Carolina hurt by the decline of tobacco. The court must review the law for compliance with the intent outlined in the consent decree. The foundation would receive 50 percent of the settlement. A trust fund for tobacco farmers and quota holders, and a second trust fund for health programs, would each get a quarter of the settlement.

Statewide Bond Issues. The State sold \$450 million of general obligation school construction bonds on March 17, 1999. Additionally, the State sold \$26,205,000 of Clean Water Refunding Bonds on March 17, 1999. The refunding bonds provided funds for refunding \$24 million of Clean Water Bonds, Series 1994A.



REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION

YEAR 2000 ISSUES

The Year 2000 issue is the result of shortcomings in many electronic data processing systems and other equipment that may adversely affect operations in the year 1999 and beyond. For many years, programmers eliminated the first two digits from a year when writing programs. For example, programmers would designate January 1, 1965 as "01/01/65" instead of "01/01/1965." On January 1, 2000 at 12:00:01 a.m., the internal clock in computers and other equipment will roll over from "12/31/99" to "01/01/00." Unfortunately, many programs (if not corrected) will not be able to distinguish between the Year 2000 and the year 1900. This may cause the programs to process data inaccurately or to stop processing data altogether. Another factor that may cause problems in programs is the leap year calculation. Some programs are unable to detect the Year 2000 as a leap year.

All information systems in North Carolina that use dates to generate data will be affected by the new millennium: for example, kindergarten registration and blood supply could be affected. In addition, non-information systems such as forms need to be evaluated because they provide input to software applications. Mail processing equipment may need to be modified to handle the new millennium. Other areas such as elevators, security systems, and vaults will be affected by the Year 2000.

In early 1997, the Year 2000 Project Team (including a statewide Steering Committee and agency co-ordinators) was formed to manage the Year 2000 project from a statewide perspective. The Year 2000 Project Team is responsible for prioritizing systems statewide, developing and maintaining statewide conversion schedules, analyzing third-party product compliance, maintaining a statewide Year 2000 repository, defining the overall conversion approach and milestones, reporting the status of statewide conversion projects, providing statewide communications and coordination, reporting the status of statewide Year 2000 funding and use, reporting the status of statewide quality assurance, developing and maintaining a statewide risk management plan, coordinating the Year 2000 budget process, maintaining an evolving cost estimate, and analyzing the automated tool offerings.

The executive departments, universities, university hospitals, and community colleges are responsible for completing the Year 2000 conversion efforts in their areas. They will work within the framework set forth by the Year 2000 Steering Committee and carried through by the Statewide Year 2000 Project Team.

As of year-end, the State has contracted with several vendors for assistance in addressing the year 2000 issues relating to its computer systems and other electronic

equipment. The amount of those commitments is approximately \$36.7 million.

The following stages have been identified as necessary to address the Year 2000 issue.

Awareness Stage—Encompasses establishing a budget and project plan (for example, a timeline or chart noting major tasks and due dates) for dealing with the Year 2000 issue.

Assessment Stage—When the organization begins the actual process of identifying all of its systems (preparing an inventory) and individual components of the systems. An organization may decide to review all system components or, through a risk analysis, identify only mission-critical systems and equipment systems and equipment critical to conducting operations.

Remediation Stage—When the organization actually makes changes to systems and equipment. This stage deals primarily with the technical issues of converting existing systems, or switching to compliant systems. During this stage, decisions are made on how to make the systems or equipment issues, and the required system changes are made.

Validation/Testing Stage—When the organization validates and tests the changes made during the conversion process. The development of test data and test scripts, the running of test scripts, and the review of test results are crucial for this stage of the conversion process to be successful. If the testing results show anomalies, the tested area needs to be corrected and retested.

As of year-end, the Year 2000 Project Team reported 174 computer systems in the assessment stage, 121 computer systems in the remediation stage and 140 computer systems in the validation/testing stage. These systems have been grouped by function in the table below.

REQUIRED SUPPLEMENTARY INFORMATION

Functional Category	Assessment	Remediation	Validation/ Testing
General government	13	13	10
Education	9	8	6
Health and human services	17	13	8
Economic development	1	8	11
Environment and natural resources	1	21	3
Public safety, corrections, and regulation	9	23	5
Transportation	9	16	15
Agriculture	2	—	7
Universities	113	19	75
Total	<u>174</u>	<u>121</u>	<u>140</u>

The assessment process for computer systems is continuous and ongoing. The Year 2000 Project Team has just begun an assessment of other electronic equipment that may require replacement or adjustment.

Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that the State and its component units are or will be year 2000 ready, that the State's and its component units' remediation efforts will be successful in whole or in part, or that parties with whom the State and its component units do business will be year 2000 ready. In addition, the completion of these stages is not a guarantee that systems and equipment will be Year 2000-compliant.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS
ALL PENSION TRUST FUNDS

June 30, 1998

(Expressed in Thousands)

<i>Retirement System</i>	<i>Valuation Date</i>	<i>Actuarial Value of Assets</i>	<i>Actuarial Accrued Liability (AAL)</i>	<i>Unfunded AAL (UAAL) (b) - (a)</i>	<i>Funded Ratio (a) / (b)</i>	<i>Annual Covered Payroll (c)</i>	<i>UAAL as a Percentage of Covered Payroll ((b-a)/c)</i>
		(a)	(b)	NOTE 1			
Teachers' and State Employees'	12-31-97	\$ 27,765,057	\$ 28,071,156	\$ 306,099	98.9%	\$ 7,373,713	4.2%
	12-31-96 ^A	25,357,460	25,478,193	120,733	99.5%	6,845,185	1.8%
	12-31-95	22,178,592	22,663,750	485,158	97.9%	6,595,618	7.4%
	12-31-94	20,394,957	20,908,734	513,777	97.5%	6,323,410	8.1%
	12-31-93	18,695,663	19,274,394	578,731	97.0%	5,975,648	9.7%
	12-31-92	17,039,908	17,608,007	568,099	96.8%	5,695,451	10.0%
Consolidated Judicial	12-31-97	\$ 207,706	\$ 199,204	\$ (8,502)	104.3%	\$ 39,698	(21.4)%
	12-31-96 ^A	188,722	183,442	(5,280)	102.9%	36,608	(14.4)%
	12-31-95	164,358	175,126	10,768	93.9%	35,665	30.2%
	12-31-94	151,366	161,732	10,366	93.6%	34,114	30.4%
	12-31-93	138,419	148,495	10,076	93.2%	29,832	33.8%
	12-31-92	125,804	138,835	13,031	90.6%	29,335	44.4%
Legislative	12-31-97	\$ 16,186	\$ 14,761	\$ (1,425)	109.7%	\$ 3,605	(39.5)%
	12-31-96 ^A	14,563	13,715	(848)	106.2%	3,573	(23.7)%
	12-31-95	12,883	12,685	(198)	101.6%	3,616	(5.5)%
	12-31-94	11,281	11,137	(144)	101.3%	3,309	(4.4)%
	12-31-93	9,611	8,854	(757)	108.5%	2,264	(33.4)%
	12-31-92	8,476	8,005	(471)	105.9%	2,171	(21.7)%
Firemen's, Rescue Squad Workers'	6-30-97 ^A	\$ 142,169	\$ 173,030	\$ 30,861	82.2%	N/A	N/A
	6-30-96	123,265	160,233	36,968	76.9%	N/A	N/A
	6-30-95	110,196	157,644	47,448	69.9%	N/A	N/A
	6-30-94	101,563	123,691	22,128	82.1%	N/A	N/A
	6-30-93	94,542	110,204	15,662	85.8%	N/A	N/A
	6-30-92	87,265	106,055	18,790	82.3%	N/A	N/A
National Guard	12-31-97	\$ 30,274	\$ 42,766	\$ 12,492	70.8%	N/A	N/A
	12-31-96 ^A	26,648	39,421	12,773	67.6%	N/A	N/A
	12-31-95	22,643	37,559	14,916	60.3%	N/A	N/A
	12-31-94	20,159	34,817	14,658	57.9%	N/A	N/A
	12-31-93	17,874	33,037	15,163	54.1%	N/A	N/A
	12-31-92	15,636	30,301	14,665	51.6%	N/A	N/A
Local Governmental	12-31-97	\$ 6,928,217	\$ 6,991,702	\$ 63,485	99.1%	\$ 2,742,504	2.3%
	12-31-96 ^A	6,258,674	6,321,622	62,948	99.0%	2,593,671	2.4%
	12-31-95	5,411,167	5,472,970	61,803	98.9%	2,429,402	2.5%
	12-31-94	4,911,161	4,971,957	60,796	98.8%	2,280,714	2.7%
	12-31-93	4,436,587	4,517,945	81,358	98.2%	2,142,313	3.8%
	12-31-92	3,986,769	4,071,883	85,114	97.5%	2,030,472	4.2%

NOTE 1 a negative UAAL denotes excess actuarial assets**N/A** - Not applicable**A** - Actuarial value of assets was revised from cost to 5-year smoothed market

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 85.

REQUIRED SUPPLEMENTARY INFORMATION**SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS AND OTHER CONTRIBUTING ENTITIES****ALL PENSION TRUST FUNDS**

For the Six-Year Period 1993 to 1998 (July 1 to June 30)

(Expressed in Thousands)

<i>Retirement System</i>	<i>State Fiscal Year</i>	<i>Annual Required Contribution</i>	<i>Percentage Contributed</i>
Teachers' and State Employees'	1998	\$ 610,377	100%
	1997	593,481	100%
	1996	559,980	100%
	1995	564,336	100%
	1994	526,332	100%
	1993	499,525	100%
Consolidated Judicial	1998	\$ 8,485	100%
	1997	7,976	100%
	1996	7,536	100%
	1995	7,371	100%
	1994	6,991	100%
	1993	7,035	100%
Legislative	1998	\$ 741	108%
	1997	742	108%
	1996	725	104%
	1995	739	156%
	1994	586	142%
	1993	598	109%
Firemen's, Rescue Squad Workers'	1998	\$ 11,735	100%
	1997	11,735	100%
	1996	11,735	100%
	1995	7,449	100%
	1994	5,247	100%
	1993	5,199	100%
National Guard	1998	\$ 2,533	100%
	1997	2,303	100%
	1996	2,283	100%
	1995	2,189	100%
	1994	2,189	100%
	1993	2,123	100%
Local Governmental Employees'	1998	\$ 149,058	100%
	1997	142,952	100%
	1996	136,390	100%
	1995	129,915	100%
	1994	123,260	100%
	1993	116,387	100%

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 85.